BEFORE THE

PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules and Electric Service Regulations	)))))))))	**Docket No. 11-035-200**

REDACTED
Prefiled Direct Testimony of

J. Robert Malko

on Revenue Requirement

On behalf of

Utah Industrial Energy Consumers

June 11, 2012

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DIRECT TESTIMONY OF J. ROBERT MALKO

Q Please state your name and business address.

A J. Robert Malko. My business consulting address is 245 North Alta Street, Salt Lake City, Utah 84103.

Q What is your occupation?

A I am a Professor of Finance in the Huntsman School of Business at Utah State University located in Logan, Utah.

Q On whose behalf are you appearing in this proceeding?

A I am appearing on behalf of the Utah Industrial Energy Consumers ("UIEC"). Members of UIEC purchase substantial quantities of electricity from Rocky Mountain Power ("RMP" or the "Company") in Utah, and they are clearly interested in the outcome of this proceeding.

Q Please describe your educational background and experience.

A This information is included in Appendix A to my testimony.

Q What is the primary purpose of your direct testimony in this proceeding?

A The primary purpose of my direct testimony is to make a prudence evaluation based on an examination of the natural gas hedging management practices as they relate to the Company's fixed for variable swaps that have resulted in the losses forecasted for the test period of June 1, 2012 through May 31, 2013.

Q What do you conclude?

A The Company was imprudent in failing to actively manage the natural gas fixed for variable swaps so as to balance the goals of cost minimization and price stability and to respond effectively to significant changes in business risks.

Q What do you recommend based on these conclusions?

A I recommend that the Utah Public Service Commission ("Commission") find that the Company was imprudent in its failure to actively manage its natural gas fixed for variable swaps and that the Commission disallow $16,503,595 from the Company's revenue requirement request. This disallowance is not based on the Company's purchasing behavior, as my recommendation was in the past case, but instead on the Company's failure to be an active manager as it relates to fixed for variable natural gas swaps, especially since the advent of inclusion of these costs in the recently approved energy balancing account ("EBA"). I will explain this distinction in more detail below. Mr. Mark Widmer, an additional expert testifying on behalf of UIEC, explains the calculations for the proposed disallowance in his testimony. The recommended disallowance for imprudent behavior by PacifiCorp managers is intended to be a permanent write-off in the base rates and not to be collected from the ratepayers by the Company through other mechanisms such as its EBA.

Q In general, how would you describe the Company natural gas hedging performance with financial fixed for variable swap products?

A The Company's performance has been extremely poor. The Company has lost hundreds and hundreds of millions of dollars and continues on this path. In total the Company's losses are essentially [redacted], which should get anyone's attention. Cumulative losses from January 2007 through March 2012, are [redacted], and the mark-to-market losses through 2013 are [redacted]. UIEC Confidential Exhibit __ (JRM-1). In total these losses would amount to [redacted]. In fact, it appears the Company has had substantial losses from its natural gas fixed for variable swap strategy for [redacted] ***straight months*** as of March 2012, and the mark-to-market period shows that another 21 consecutive months of losses are expected through the end of 2013. Id. In [redacted] of these months, the Company lost or currently expects to lose ***more than $10 million per month***. Id.; See also Exhibit RMP __ (GND-1). Because the Company appears to intend to allow its natural gas fixed for variable swap hedging program to continue on this pre-set path of destruction with no plan to intercede with intelligent reevaluation, it is time the Commission put a stop to this behavior and order the shareholders to share in at least some of these losses. In other words, the Company management failed to change its natural gas fixed for variable swaps hedging program in response to those significant losses and associated changes in business risk conditions in the natural gas market.

Also, the world changed when the Commission approved an EBA. At that time, a significant portion of the risk of bad judgment, errors, and imprudence shifted from the Company and its shareholders to the ratepayers, who have no say in the management of the Company. Therefore, the Commission must be very diligent to prevent unjust and unreasonable costs from being passed onto the ratepayers.

As a result of the settlement of the last general rate case, Docket No. 10-035-124, the parties agreed that the Commission should remove from the EBA Order language excluding financial swap transactions from the newly approved EBA. Therefore, from that time the risk of losses on those transactions shifted from the Company to the ratepayers. This means that as of that point in time, the Company lost a significant portion of its incentive to dispose of bad investments or mitigate their losses, which makes it imperative for the Commission to now step in to protect ratepayers.

Q But isn't there a 70/30 mechanism in the EBA so that the Company would have to share in those losses?

A The 70/30 sharing mechanism gives the Company even less incentive to act prudently. The Company can now fail to act prudently knowing that it will not be held 100% accountable for that imprudence, whereas it faced all that risk in the past. Ratepayers could have to eat at least 70% of the Company's imprudence because, unless found imprudent in this general rate case, 70% of the costs, including fixed for variable swap losses, will be passed onto ratepayers. This makes it more important than it has ever been before for this Commission to scrutinize the costs the Company attempts to pass onto ratepayers and make a prudence disallowance before these costs get put into the EBA to saddle ratepayers with 70% of them.

In fact, it is my understanding that in the Company's current requested EBA cost recovery application, Docket No. 12-035-67, a significant portion of these imprudent fixed for variable natural gas swaps occur in the period at issue there, October 1, 2011, through December 31, 2011. What I testify to here is directly applicable to those costs as well.

Q Is there anything else that brought you to your conclusion?

A Yes. If one considers the hub price for natural gas at Henry Hub for each month from January 2009 through March 2012 there is a noticeably distinct and steady decline from June 2011. UIEC Exhibit __ (JRM-2). In fact, information provided in UIEC Confidential Attachment 8.4-2 shows that the biggest part of the recent price decline occurred between June 30, 2011 and March 31, 2012. The September 2011 quarter-end was 9% below the June 2011 quarter-end; the December 2011 quarter-end was 21% below the September 2011 quarter-end; and the March 2012 quarter-end was 21% below the December 2011 quarter-end. UIEC Confidential Exhibit __ (JRM-3). If the Company was going to be held 100% accountable for the fixed for variable swap losses, it arguably would have taken action when it could, or at least should, have seen the writing on the wall.

In fact, the Company has admitted that "[s]ince the middle of 2008, forward market prices for natural gas and electricity have generally steadily fallen." WY Docket No. 20000-405-ER-11, D. Test. S. Bird, 9:1-2 (Dec. 2011), UIEC Exhibit __ (JRM-4). So, the Company has been aware and is aware but sits passively by. Moreover, the Company has clearly recognized the decline and sustainability in natural gas prices by its decision not to retrofit the environmental controls on Naughton 3 but to instead convert the generation facility to natural gas.

Q But doesn't the Company say that it also has electric swaps and that there have been gains there to off-set the natural gas fixed for variable swap losses?

A Yes, but having gains in electric does not mean you need natural gas losses, which is the effect of the Company's hedging structure. There are often different goals for each and they react to different stimuli. Besides, if your 401K had one stock that performed abysmally for over three years, would you just hold on and accept those losses because you happened to have another stock in your 401K that performed well? Of course not, and the same should hold here. Central or critical to the investment management process is selecting what to purchase and when to purchase it, <u>and</u> deciding what to sell and when to sell it. A hedging strategy is not a simple motor whereby you set some dials and push some buttons and then let it run unattended. It needs to be actively watched and monitored in conjunction with what is going on in the market place, what others are doing, and what risk ratepayers are willing to bear. Also, prudence is not only measured by the Company's slavish adherence to a set policy but how it reacts to business risk changes.

Q Do the natural gas fixed for variable swaps and electric power fixed for variable swaps need to be considered together?

A No. First of all, my understanding is that RMP did not start purchasing fixed for variable electric swaps until approximately 2008. From what I have been able to determine, it started some type of natural gas hedging as early as

2005. If they had some real connection in an overall program, the purchasing start would have coincided. In addition, the highly confidential May 11, 2010, PacifiCorp Risk Oversight Committee Meeting Minutes state: [redacted] Thus, at least the feasibility of developing independent hedging programs for natural gas and electricity were recognized by the Company at that time. Plus, as early as October 8, 2009, Mr. Douglas D. Wheelwright testified for the Division of Public Utilities ("Division") about the problems of combining natural gas and electric swaps together. Prefiled D. Test. D. Wheelwright, Docket No. 09-035-23, 1:22-24, 9:227-10:254 (Oct. 8, 2009).

More importantly, there are distinctively different goals to be achieved by engaging in the electric power fixed for variable swap market. Electric power fixed for variable swaps are primarily to protect against a price fall. The Company wants to keep a floor under its electric power prices to avoid a significant loss. Without the electric power swaps, the Company could not capture its gains on the resale of electricity from its own resources in a declining price market, like what exists today. At least one would hope that the Company's practice of trading in electric swaps is limited to the disposition of surplus owned-capacity and does not reflect trading in electricity; especially given the fact that with the advent of the EBA, customers have assumed a much greater share of this risk.

Natural gas hedges, on the other hand, protect against price increases in natural gas, a phenomenon not recently experienced and, according to most observers, not likely to be experienced by meaningful increases for quite some time. UIEC Exhibit __ (JRM-5).

Also, linking the two programs together assumes that the price of natural gas and the price of electricity will always move in tandem, which may not occur after significant events such as Hurricane Katrina or the Western Energy Crisis. It also assumes the company will remain in a long position with excess power and that the correlation between electricity pricing and natural gas pricing will remain unchanged. But, the Company will not remain in a long position indefinitely. The expiration of long term contracts, which the Company has pointed to in this and the last general rate case, along with increasing loads, will significantly change the dynamic between the Company's natural gas and electricity positions.

By not developing a separate or internal diversification strategy for natural gas hedging, the Company managers have not actively changed strategies in response to significant business risk changes such as substantial falling natural gas prices. The result of this failure is price stability at unreasonably high costs and ignoring cost minimization. The financial goal of any prudent natural gas hedging program should not be obtaining a level of price stability at unreasonably high cost.

Q How is your criticism of the Company's management of its natural gas fixed for variable swaps different from what you testified to in the last case?

A In the last case, I testified:

> PacifiCorp should have reduced its 100% reliance on fixed for variable financial natural gas swaps and have some portion of its program exposed to the market in order to capture the benefits of increased supply of natural gas and associated price decline. PacifiCorp should have followed the conclusions of its EROC and actually implemented changes to be more flexible and address concerns raised by natural gas price reductions and cost minimization considerations. PacifiCorp risk managers should have been clearly aware of the established financial concept of diversification when developing strategies to address and mitigate risk. Therefore, in addition to using longer-term year financial swaps, PacifiCorp risk managers should have had the intelligence and foresight to have a diversified portfolio approach in the Company's hedging program for natural gas, but they failed to take any action. Buying over time is a smart strategy, but it is not sufficient on its own. It cannot be the only strategy. This diversification portfolio approach should have included at a minimum, leaving a portion of its portfolio exposed to the market. This diversified approach would provide far more flexibility in the hedging program in order to reduce costs and increase benefits to ratepayers. Diversification is a crucial concept for effective risk management: "Don't put all your eggs in one basket." Docket No. 10-035-124, D. Test. J.R. Malko, 19:395-20:406 (May 26, 2011).

This went to the purchasing strategy the Company employed—the when, what, and how much. What I am saying here goes beyond that. We are not suggesting that the Commission tell the Company how to hedge or how to diversify its hedging. Because RMP is a multijurisdictional utility, it is impractical for one regulatory jurisdiction to prescribe portfolio standards or specific practices for the Company to follow. Instead, if the Company chooses to engage in fixed for variable swap activity, it must be wise and attentive to how it conducts such activity. So, here we are saying that the natural gas fixed for variable swap strategy should have been prudently managed with an awareness of the influential externalities and the ratepayers' desire for cost minimization. The Company has to be an active manager, not a passive manager.

Q Are you saying the Company was aware of the ratepayers' desire for cost minimization?

A Yes, of course. In the last general rate case, Docket No. 10-035-124, nearly every party provided testimony opposing the Company's ability to recover for all its extremely high natural gas[1] hedging losses. In that case, Mr. Douglas D. Wheelwright testified on behalf of the Division:

> The Company has not been able to demonstrate that the current hedging policies and practices provide the appropriate balance of risk to both the Company and ratepayers. The existing hedging strategy has been designed for price stability and ***does not adequately consider the potential cost impact***. . . . The program creates price stability for rate making purposes but reduces the incentive for the Company to look for possible cost savings opportunities. . . . ***Cost minimization does not appear to be a consideration in the current program***. . . . In the Questar Gas pass-through docket the Commission indicated that Questar should consider cost, reliability and price stability as the three factors that should influence a gas purchase strategy. . . . [T]he Division is concerned that the Company's current hedging program and practices do not provide an appropriate degree of flexibility to adapt to changing conditions ***and are weighted too heavily toward price stability at the expense of cost minimization***. Pre-filed Direct Test. D.

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[1] The complaints were against natural gas hedging and did not appear to include complaints against electric power hedging.

Wheelwright, 2:27-3:36, 7:137-138, 14:312-314, 16:350-353 (May 26, 2011) (emphasis added).

The Company has been aware of the ratepayers' intolerance to these losses but has done very little in response. In fact, in the highly confidential May 11, 2010, PacifiCorp Risk Oversight Committee Meeting minutes it was noted that [redacted] The Company, however, ignored its own mandate that it [redacted] Id. August 6, 2007.

Despite what is stated in the recently issued Semi-Annual Hedging Report,[2] the Company has completely disregarded cost minimization as a goal and failed to actively manage its natural gas fixed for variable swaps to include that goal. The Company's statement in the Semi-Annual Report appears meant to appease the complaints from intervenors and regulators, but no action supports the statement. In fact, when asked in a data request in this subsequent case as to the purpose of its hedging programs, the Company responded: "to reduce the volatility of net power costs which impacts customers' bills." UIEC Exhibit __ (JRM-7). The concept of balancing price stability with cost minimization continues to fall on deaf ears.

[2] The Company states in that report: [redacted] UIEC Confidential Exhibit __ (JRM-6).

Q Wasn't a collaborative process conducted to discuss the Company's hedging practice?

A Yes, it was. In the last general rate case, Docket No. 10-035-124, the Division, Office of Consumer Services ("Office"), UAE, and UIEC all proposed disallowances to the Company's requested revenue requirement due to imprudent natural gas hedging purchasing strategies. The recommended disallowances ranged from approximately $13 million to $25 million. As a result, at least in part, the Company agreed in the settlement of that case to "convene a collaborative process ("Collaborative Process") to discuss appropriate changes to the Company's hedging practices to better reflect ***customer risk tolerances*** and preferences." Docket Nos. 10-035-124, 09-035-15, 10-035-14, 11-035-46, 11-035 47, ¶ 53 (July 28, 2011) ("Settlement Stipulation") (emphasis added).

Q Did UIEC participate in that Collaborative Process?

A Yes, UIEC participated in that process, which I believe consisted of a number of meetings held over several months. At the conclusion, the Division filed a report and UIEC submitted comments, both of which I have read. It appears there were some areas of agreement but no comprehensive agreement was reached among all parties. The Division's report does not address cost minimization at all. There is no mention or discussion of prudent management of fixed for variable swaps or prudent management of any of the Company's hedging programs so that they address and balance the objectives of price stability and cost minimization.

Q Then what are you suggesting in this case?

A I'm suggesting that a prudent manager should have actively monitored the situation, taken note of the signs, and taken some kind of action in order to address and balance the objectives of price stability and cost minimization. I am not suggesting this through hindsight, which would be inappropriate in a prudence review.[3] But there were numerous signs that spoke for action, and others took action. Nevertheless, the Company held to its original plan despite the fact that the Risk Management Committee advised it [redacted] PacifiCorp Risk Oversight Committee Meeting Minutes, August 6, 2007.

Q What types of signs do you mean?

A Well, in addition to nearly every party telling the Company that its natural gas fixed for variable swap losses were intolerable to ratepayers in several prior proceedings, the numbers themselves should have been a warning. As I mentioned above, the Company expects ratepayers to cover [redacted] million in swap losses, [redacted] straight months of losses with more than $10,000,000 in losses per month in [redacted] of these months**.** UIEC Confidential Exhibit __ (JRM-1). We have seen recently, in the case of JP Morgan Chase, that when a company without the luxury of having ratepayers to pay its losses does

[3] J. Robert Malko, Vicki M. Baldwin, "Prudence Review and Traditional Revenue Requirement Regulation: Some Thoughts," The Electricity Journal, Vol. 24, No. 8, pg. 88-91, October 2011. See UIEC Exhibit __ JRM-14a.

experience such losses, that company's management acts, it acts decisively, and it acts quickly. UIEC Exhibit __ (JRM-8).

Another red flag, as mentioned above, was that there is a distinctively noticeable and steady decline in the price of natural gas since June 2011. In fact, the biggest part of the recent price decline occurred between June 30, 2011 and March 31, 2012. The September 2011 quarter-end was 9% below the June 2011 quarter-end; the December 2011 quarter-end, which is the current EBA recovery period, was 21% below the September 2011 quarter-end;[4] and the March 2012 quarter-end was 21% below the December 2011 quarter-end.

The Company itself finally recognized the decline and sustainability in natural gas prices when it made its decision not to retrofit the environmental controls on Naughton 3 but to instead convert the facility to natural gas. The Company's witness Mr. Teply testified in a Wyoming case considering this matter:

> The most important factor in the Company's alternative decision is the assumption of forecast natural gas prices. Since the Company's original Application filing, actual forward natural gas market prices have continued to decline and longer term natural gas price forecasts provided by third party experts have followed. WY Docket No. 20000-400-EA-11, Reb. C. Teply, 2:17-21 (April 2012) UIEC Exhibit __ (JRM-9).

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[4] This demonstrates a significant loss for the current EBA recovery period of the quarter ending December 31, 2011.

As the Company noted in response to a data request, Mr. Teply's rebuttal in that case was dependent on the December 2011 official forward price curve ("OFPC"), UIEC Exhibit __ (JRM-10), the same OFPC used in the original filing in this case.

These are just a few of the indicators of which a prudent Company would have taken notice and then should have taken some action. Now, with the risk having been shifted to ratepayers due to the approval of including swap losses in the EBA, it is incumbent upon the Commission to conduct a strict prudence review.

Q What are you suggesting should have been done?

A The Company should have been attentive to the market signs and at some point cut its losses and liquidated at least a portion of its natural gas hedged position.

Q Is this possible?

A In response to UIEC data requests, the Company states that it could liquidate its natural gas swaps through fixed price sales and that the ability to do so "is subject to the same market availability of any other swap transaction." UIEC Exhibit __ (JRM-11). In fact, additional discovery shows that the Company did sell several swaps in 2011,[5] only two of which impact the test year. UIEC Confidential Exhibit __ (JRM-6). Therefore, it was possible. The Commission needs to consider this and take action to protect the ratepayers.

Q. You mention that others took action. What are you referring to?

A. For example, Berkshire Hathaway Inc. ("Berkshire") is a holding company owning a number of subsidiaries with diverse business activities. One of these subsidiaries is MidAmerican Energy Holding Company ("MEHC"), which is the parent company to PacifiCorp d/b/a Rocky Mountain Power.

Berkshire's Form 10-K for the fiscal year ended December 31, 2010, noted:

> During the fourth quarter of 2010, we recorded other-than-temporary impairment charges of $1,020 million with respect to certain fixed maturity securities where we concluded that we were unlikely to receive all remaining contractual principal and interest amounts when due. These securities had been in an unrealized loss position for more than two years. Berkshire 2010 Form 10-K at note (3) of Notes to Consolidated Financial Statements, UIEC Exhibit (JRM-12).

More telling is the Note to Shareholders included in Berkshire's 2011 10-K. In there, Berkshire states:

> A few years back, I spent about $2 billion buying several bond issues of Energy Future Holdings an electric utility operation serving portions of Texas. . . . In large measure, the company's prospects were tied to the price of natural gas, ***which tanked shortly after our purchase and remains depressed***. . . . ***We wrote down our investment by $1 billion in 2010*** [the referenced write down in the 2010 10-K] ***and by an additional $390 million last year*** [2011]. Berkshire 2011 Form 10-K Note to Shareholders at 4 (emphasis added) UIEC Exhibit (JRM-13).

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[5] Only three were sold after it was agreed that the swap losses were to be included for recovery in the EBA.

Thus, after only two years of ***un***realized loss, Berkshire was willing to take some action and write-down $1 billion. Berkshire took additional action the following year and wrote-down an additional $390 million. The Company on the other hand, holds to its original position racking up hundreds of millions in losses regardless of what is happening around it, which arguably will never be completely realized by PacifiCorp because of the EBA. Therefore, with swap losses in the EBA, the Company has much less reason to act.

Q Is there any sign the Company has considered the impacts of the falling gas prices on its hedges?

A Yes. In addition to deciding to convert Naughton 3 to natural gas, the Company addressed the situation in its Risk Oversight Committee. In the highly confidential minutes of the meeting held January 23, 2012, the Committee discussed [redacted] He also noted the [redacted]

[redacted] Nevertheless, the Committee concluded [redacted] the Company clearly suffered a cost in working capital by missing an opportunity to earn interest income.

Q Why do you recommend the Commission act?

A The Company's managers are the direct or primary financial agents of the common equity shareholders (owners) of the electric utility. Moreover, considering that RMP is a regulated electric utility, RMP's managers have financial responsibilities to the utility ratepayers by providing reliable service at reasonable prices. By not actively managing the natural gas fixed for variable swaps in response to the significant decline in natural gas prices, the Company's managers failed in their financial responsibilities to both shareholders and ratepayers. Considering the legal and economic framework of regulation, unreasonable costs associated with imprudent utility managers' behavior should be borne by shareholders, not ratepayers. Imprudent management behavior and resulting increases in risks and costs should not be shifted to and paid for by risk-adverse ratepayers. Furthermore, imprudent management behavior needs to be communicated to shareholders (the owners of the Company) so that they can take appropriate action with respect to management of their Company. Sheltering and protecting electric utility managers from a reasonable finding of imprudent behavior only benefits the utility managers and clearly does not serve the public interest, including the interests of shareholders and ratepayers. Also, it is especially important that the Commission act now and declare at least a portion of the natural gas fixed for variable swap losses imprudent in this case because (1) the risk has been shifted to the ratepayers with the EBA, and (2) some of the Company's biggest losses appear to have occurred in the fourth quarter of 2011, which is the period at issue in the current EBA recovery period. UIEC Confidential Exhibit __ (JRM-1). Natural gas prices have risen slightly in the last few months so the losses going forward, in combination with the Company's action to leave some of its portfolio open to market as we recommended in the last case, means that losses should begin to decline.

Q What action do you recommend the Commission take?

A Being an economist, it is difficult for me to arrive at an exact solution when considering efficiency and fairness issues within a regulatory framework. As Dr. James C. Bonbright recognized, fairness or equity are "restraints against the unqualified acceptance of general principles of rate making based on considerations of maximum economic or social efficiency."[6] Also, Dr. Edward E. Zajac noted, "one must bear in mind the inherent conflict between economic efficiency, which satisfies a very minimum criterion of economic justice, and other possible justice of fairness viewpoints."[7] This led Dr. Zajac to conclude that regulation is much more effective than the competitive market place to

[6] James C. Bonbright, Principles of Public Utility Rates, at 134. See UIEC Exhibit __ (JRM-14b).

[7] Edward E. Zajac, FAIRNESS OR EFFICIENCY: AN INTRODUCTION TO PUBLIC UTILITY PRICING, at 105, Bell Laboratories (1978). See UIEC Exhibit __ (JRM-14c).

bring about economic and social justice.[8] Also, as the behavioral economist and Nobel Prize winner Dr. Daniel Kahneman discovered, "exploitation of market power to impose losses on others is unacceptable."[9] Dr. Kahneman's research and the acknowledged role of the regulator would suggest that fairness and related unjust enrichment dictate that the Company shoulder responsibility for 100% of the approximately $150 million in natural gas swap losses for the test period in this case. Nevertheless, based on the concept that cost minimization should be at least equal in importance to price stability, I would propose a 50/50 sharing of the losses. However, if different weights were assigned to the two primary objectives of cost minimization and price stability, then a different sharing of losses between shareholders and ratepayers would result.

Q. Does that mean you are suggesting that the Company's shareholders and ratepayers share 50/50 in the approximately $150 million in natural gas fixed for variable swap losses for the test period?

A. Not exactly. As natural gas prices dropped drastically, some amount of natural gas fixed for variable swap losses would have been likely even under an actively managed, prudent program. This also suggests the fairness of the 50/50 split, but then raises the question of when the losses should start being deemed imprudent. Based on the evidence, it appears there could be a number of different starting points.

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[8] Id. at 104-05.

[9] Daniel Kahneman, Thinking, Fast and Slow, at 306 (2011). See UIEC Exhibit __ (JRM-14d).

Q What are those starting points?

A I would say that one would be June 2011, which is the point when a distinctively noticeable and steady decline in the price of natural gas began to occur. Another could be the date when ratepayers assumed the risk of swap losses in the EBA, which was the end of July 2011.

Q What would the different disallowances be under each of those scenarios?

A For the June 11 point in time, the Company losses would be $79,195,752, Utah losses $34,016,952, and 50% of those allocated to the Company would be $17,008,476. For the EBA date of the end of July 2011, the Company losses would be $74,494,047, Utah losses $31,997,428, and 50% of those allocated to the Company would be $ 15,998,714. These calculations are explained in Mr. Widmer's direct testimony. Because these numbers are so close, I recommend we take the midpoint between the two--$16,503,595.

Q So what do you conclude?

A I conclude that it is imperative given the advent of the shifting of risks to ratepayers with an EBA and then the inclusion of swap losses in that EBA, that the Commission find that the Company was unreasonable and imprudent in its failure to actively manage its natural gas fixed for variable swaps despite the indicators that a reasonable and prudent company would have, and other companies did, act on. Therefore, depending on the point in time the

Commission feels most reasonable, I recommend that the Company and its shareholders share at least half of the average of the Utah allocated losses if measured from June 2011, and end of July 2011, or $16,503,595. However, if different weights were assigned by the Commission to the two primary objectives of cost minimization and price stability, then a different sharing of losses between shareholders and ratepayers would result. Also, similar to what the Commission does with Questar, I believe the Commission should state explicitly that the Company should consider cost in its natural gas purchasing strategy.

In summary, the Company management was unreasonable and imprudent because of (1) failure to address and balance the goals of price stability and cost minimization, (2) failure to actively manage its natural gas fixed for variable swaps as business risks significantly changed, and (3) failure to recognize and address the flaws in its matching hedging program. By being passive risk managers and refusing to implement appropriate and timely changes, these imprudent failures by RMP managers have resulted and continue to result in hundreds of millions of dollars of excessive costs being assigned to RMP ratepayers.

Q Does that conclude your direct testimony?

A Yes, it does.

APPENDIX A

QUALIFICATIONS OF J. ROBERT MALKO

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is J. Robert Malko. I am a Professor of Finance in the Huntsman School of Business at Utah State University located in Logan, Utah. My business consulting address is 245 North Alta Street, Salt Lake City, Utah 84103.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND ACADEMIC POSITIONS.

A. I received my Bachelor's degree, cum laude, in economics and mathematics from Loyola College in Baltimore, Maryland. I received my Master's and Doctorate degrees in economics from the Krannert Graduate School of Management at Purdue University in West Lafayette, Indiana. I have also taken graduate courses in corporate finance and investment theory at the University of Wisconsin at Madison. I was a Visiting Scholar in industrial engineering at Stanford University in Palo Alto, California. At Utah State University, I teach undergraduate level and graduate level courses in Corporate Finance and Applied Microeconomics.

Q. PLEASE DESCRIBE SOME OF YOUR PRIOR WORK EXPERIENCE.

A. I served during the periods 1975-1977 and 1981-1986 as the Chief Economist for the Public Service Commission of Wisconsin. During this time, I also served as Chair and Vice-Chair of the National Association of Regulatory Utility

Commissioners ("NARUC") Staff Subcommittee on Economics and Finance. From 1977-1981, I was Project Manager, and then Program Manager, for The Electric Utility Rate Design Study. This study was housed at the Electric Power Research Institute ("EPRI") in Palo Alto, California and prepared for NARUC. In 1981-1982, I was the Senior Staff Advisor to the NARUC Ad Hoc Committee on Utility Diversification. I assisted the Committee in the preparation and publication of their Final Report in 1983. I served on the Board of Directors at the National Regulatory Research Institute ("NRRI"), located at the Ohio State University, between 1997 and 2003. I have served on the Board of Directors of the Society of Utility and Regulatory Financial Analysts (SURFA) between 1988 and 1996 and 2002 to 2010. I am also a Certified Rate of Return Analyst which is certified by SURFA. I currently serve on the Advisory Council for the Center of Public Utilities at New Mexico State University.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS?

A. Yes. I have testified on behalf of state regulatory commissions, state offices of consumer counsel, energy utilities and customer groups. I have presented testimony before the Arizona Corporation Commission, the Connecticut Public Utilities Control Authority, District of Columbia Public Service Commission, the Federal Energy Regulatory Commission, the Hawaii Public Utilities Commission, the Illinois Commerce Commission, the Maryland Public Service Commission, the Minnesota Public Utilities Commission, the New Hampshire Public Utilities Commission, the New Jersey Board of Public Utilities, the Nevada Public Service

Commission, the New York Public Service Commission, the Pennsylvania Public Utility Commission, the Public Service Commission of Wisconsin, the Public Service Commission of Utah, Utah State Tax Commission, and the Virginia State Corporation Commission.

Q. PLEASE SUMMARIZE YOUR PUBLICATIONS CONCERNING REGULATION AND PUBLIC UTILITY ISSUES.

A. I have written (co-authored) approximately 170 articles on public utility economics and finance that have been published in books and journals including, Forum For Applied Research and Public Policy; Journal of Business Administration; Journal of Energy Law and Policy; The Journal of Energy and Development; Energy: The International Journal; and Wisconsin Law Review. I am co-editor of Electric Utilities Moving Into The 21st Century published by PUR in 1994, Reinventing Electric Utility Regulation published by PUR in 1995, and Customer Choice: Finding Value in Retail Electricity Markets published by PUR in 1999.