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8 **BEFORE THE GUAM PUBLIC UTILITIES COMMISSION**

9 **IN THE MATTER OF:**

10 **GUAM POWER AUTHORITY**

11 **LEVELIZED ENERGY ADJUSTMENT**

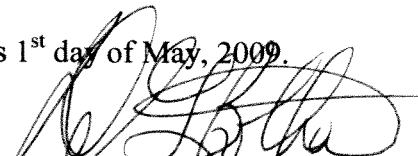
12 **CLAUSE (LEAC)**

13 **DOCKET NO. 02-04**

14 **GPA RESPONSE TO PUC REGARDING**
15 **VOLATILITY OF OIL PRICES AND**
16 **HEDGING PROGRAM IMPACT ON GPA**
17 **FINANCIAL LIQUIDITY**

18 **COMES NOW**, the GUAM POWER AUTHORITY (GPA), by and through its counsel
19 of record, D. GRAHAM BOTHA, ESQ., and hereby files GPA's response to the PUC regarding
20 the volatility of oil prices and the impact of the hedging program on the financial liquidity of
21 GPA. The PUC Order of April 20, 2009 reminded GPA of its duty to report on actions taken by
22 it in response to the volatility of oil prices and the impact of the hedging program on the financial
23 liquidity of GPA.

24 **RESPECTFULLY SUBMITTED** this 1st day of May, 2009.

25 
26 **D. GRAHAM BOTHA, ESQ.**
27 **GPA Legal Counsel**

28 **COPY**



GUAM POWER AUTHORITY

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29 April 2009

Mr. Frederick J. Horecky, Legal Counsel
Public Utilities Commission
643 Chalan San Antonio, Suite 102B
Tamuning, Guam 96913

SUBJECT: Public Utilities Commission Docket No.: 02-04
Ref: Volatility of Oil Prices and Hedging Program Impact
On GPA Financial Liquidity

Dear Mr. Horecky:

The Public Utility Commission Order dated January 26, 2009 under Docket 02-04 requires the Guam Power Authority (GPA) to submit a report regarding actions taken to address the impact of the volatility of fuel market pricing on GPA's financial liquidity and fuel hedging contracts. This letter is being filed to comply with this requirement.

As you are aware, world wide market prices for all types of oil reached a peak in July 2008. From there, fuel prices began a period of gradual decline through the second week of September 2008 where a more precipitous decline took place. There was a recovery of pricing in the latter half of the month of September. Then in the last few days of September, prices began an unprecedented slide that lasted until mid-December 2008. The December pricing lows appear to be the bottom of the price slide with prices increasing by as much as 48% after that point. The graph below depicts pricing activity during this period of high volatility.

Fuel Price Collapse



The crash in fuel prices was undoubtedly linked to the collapse in world wide credit markets which started in the second half of 2007 and reached a crisis mode in September and October of 2008.

As fuel prices were declining, GPA's liability under its fuel hedging program were increasing and GPA's most significant hedge provider placed a margin call on GPA and demanded either a \$30 million payment in cash or a \$30 million standby letter of credit or a combination of both.

GPA immediately placed about \$5 million in an escrow with the hedge provider and made a commitment to the hedge provider to continue making regular deposits until the margin call was met by cash deposits, a standby letter of credit or a combination thereof.

GPA also issued a Request for Proposals for a standby letter of credit. Three banks indicated an interest in the bid. GPA held a pre-bid conference to clarify the intent of the loan and explain the mechanics of the Levelized Energy Adjustment Clause which assured GPA would have the ability to repay any amounts drawn on the SBLC. Shortly after the conference, GPA was notified by two of the banks that they would be unable to respond to the bid request. The third bank requested three extensions on the deadline for the bid. In December, the third bank notified GPA that they would be unable to submit a bid but offered a counterproposal that would have included the assumption of some of GPA's existing hedge contracts. When the Authority evaluated the actual cost of money under the counterproposal, GPA found it to be unacceptable.

In addition, GPA explored the possibility of entering into an investment agreement with itself and investing some of GPA's 1999 Series A Construction Fund into the escrow fund. However, GPA's bond indenture only allowed this type of an arrangement only with the approval of the bond insurer. GPA was unable to get approval from its bond insurer to enter into this type of arrangement.

GPA's only remaining option to stave of the hedge provider from making a claim for immediate payment was to vigorously petition for a deferment of the fuel inventory true-up which began on 10/3/08 and to seek a LEAC factor based on a forecast that would ensure GPA would not be required to endure a LEAC under-recovery for the period 2/1/09 -7/31/09. Without these two concessions from the PUC, GPA would likely have faced litigation for its inability to meet its commitments under these contracts.

The LEAC factor which was set in February 2009 allowed GPA to collect sufficient funds to enable the Authority to pay off its hedging contracts which were due on February 15, March 15, and April 15. Those hedges represented the contracts which were the most negative of all of the Authority's hedge transactions. After they were paid off, GPA's cash deposit to the escrow account exceeded the margin call for the first time in more than six months. GPA has received its first refund from the escrow deposits and is expecting to receive additional refunds each month through October 15, 2009. Thus, with the help of the PUC, GPA has been able to successfully navigate through the second worst financial crisis it has ever faced.

Lessons Learned

One of the chief lessons learned from this has been the inability to rely on banks to meet GPA's liquidity needs. GPA is currently working on a petition to the PUC in order to establish a cash policy that will ensure GPA gets into a better cash position to ensure it is better able to respond to future events. GPA requests that the PUC be mindful of the trauma GPA has faced these last several months as it considers the merits of this petition.

GPA is also planning to continue its efforts to secure a standby letter of credit facility strictly for hedging losses to provide flexibility to the Authority during future periods of volatility in its hedging program.

Future Hedging

GPA intends to resume its hedging program as soon as it has willing partners. GPA has been advised there is currently limited activity in the fuel hedge trading markets making it more challenging to secure a hedge. GPA has fully paid off the hedge contracts from one hedge provider but has not yet been able to negotiate for a resumption of its fuel hedging program. GPA is planning to re-solicit for fuel hedge providers this summer with an effective date of October 1, 2009.

Please let us know if you require any additional information regarding GPA's fuel hedging activities.

Yours truly,

A handwritten signature in black ink, appearing to read 'J. Flores', with a long horizontal line extending to the right.

Joaquin C. Flores, P.E.
General Manager

Cc: Mr. Randall V. Wiegand, Chief Financial Officer
Mr. Graham Botha, Staff Attorney
Central Files
CFO 104 09