EXH. KCS-7
DOCKETS UE-22___/UG-22___
2022 PSE GENERAL RATE CASE
WITNESS: KYLE C. STEWART

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, Respondent.	Docket UE-22____ Docket UG-22____

**SIXTH EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF**

KYLE C. STEWART

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 31, 2022

PUGET SOUND ENERGY

Energy Risk Policy

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1.0 INTRODUCTION AND PURPOSE

Puget Sound Energy ("PSE" or "the Company") is fundamentally engaged in providing electric and natural gas service to its customers in a safe, dependable and efficient manner. That mission entails some inherent risks; however, it is PSE's policy that such risks—and others associated with pursuing that mission—should be anticipated, evaluated and controlled, and, when appropriate, mitigated. This Energy Risk Policy *("Policy")* describes PSE's philosophy of energy supply risk assessment, treatment and mitigation, and outlines the roles and responsibilities for performing those activities. The associated Energy Supply Transaction and Hedging Procedures Manual *("Procedures")* defines and describes roles, responsibilities, controls and reporting much more specifically.

Managing electric and gas portfolio risks is of critical importance for PSE and its customers. The nature of operating generation and distribution facilities, obtaining transmission service, securing fuel and other necessary services, and participating in wholesale energy markets generally is such that there is continuous exposure to various risks including market, asset reliability, operational, liquidity, model, and counterparty credit risk.

This *Policy* summarizes the purpose and scope of PSE's energy risk management activities within the electric and gas supply portfolios and sets forth the key risk management principles and policies to be followed in the management of these portfolios. In broad terms, this *Policy* also outlines a business structure for performing those roles.

2.0 MARKET RISK OVERSIGHT & GOVERNANCE FRAMEWORK

2.1 Governance Structure

An effective organizational structure is essential for appropriate risk governance and oversight and to promote independence and segregation of duties across functions. PSE's governance framework is a distributed risk management structure whereby authority is delegated from the Board of Directors and Chief Executive Officer (CEO) to each level of the organization; first to the CEO, then to Energy Management Committee (EMC), and then further to the business functions to operationalize policy level requirements.

PSE's oversight and governance framework are comprised of the:

- Board of Directors
- Chief Executive Officer
- Energy Management Committee (EMC)
- VP of Energy Supply & Chief Financial Officer

2.2 Delegation of Authority

Delegation of Authority ("DOA") is the formal transfer of authority types, consistent with the philosophy of decentralized decision-making and accountability. DOA is initiated at the Board-level, delegated to the CEO and further delegated to the EMC. Certain specific authorities are delegated by the CEO and EMC to VP of Energy Supply and Chief Financial Officer including but not limited to, short-term authorizations of PSE issued collateral during volatile market conditions.

Transaction authorities are defined in the *Schedule A – Authorized Transactions* located in the *Procedures*, consistent with approved hedging strategies. Transactions can only be negotiated and executed by authorized personnel with appropriate DOA unless otherwise approved by the EMC.

2.3 Roles and Responsibilities

Risk management requires a collaborative effort across multiple departments and among staff, senior management, and the Board of Directors to be effective. At the same time, lines of authority and the responsibility for managing and controlling risk must be clearly defined. To provide a proper control environment there must be a clear separation between the Front, Middle and Back Office functions. Segregation of duties is to be established and maintained throughout the system of risk controls. For the purposes of this Policy, "Roles" refer to positions within the organization (e.g. CEO, CFO, etc.) and "Responsibilities" refer to the tasks, duties, and requirements for a particular role.

2.3.1 Board of Directors

The Board of Directors oversee the business affairs of PSE, including the appointment and oversight of senior management. PSE's management is responsible for conducting the day-to-day operations of PSE pursuant to appropriate delegations of authority and oversight by the Board of Directors. The Board of Directors also approves the PSE energy supply strategies and acts as the final point of reference in violations / exceptions management.

2.3.2 Chief Executive Officer

The CEO shall maintain an Energy Management Committee (EMC) primarily composed of senior-level officers, with written Energy Risk Policy and Energy Supply Transaction and Hedging Procedures Manual and a risk management function (Middle Office) that is separate from the Front Office.

2.3.3 Energy Management Committee

The Energy Management Committee ("EMC") receives its authority from the CEO through delegation of authority to implement this *Policy*. EMC is comprised of the officers noted below as listed in the EMC Charter:

- Vice President, Energy Supply (Chair)
- Senior Vice President & Chief Financial Officer
- Senior Vice President & Chief Operations Officer
- Senior Vice President, Regulatory & Strategy
- Senior Vice President & General Counsel & Chief Ethics and Compliance Officer

The EMC reviews and submits this *Policy* for Board of Directors approval, which shall be documented in the minutes of the applicable Board meeting. Changes to this *Policy* likewise must be approved by the Board of Directors. EMC is responsible for communicating with, seeking guidance, and providing updates and reports as needed to the Board of Directors. EMC responsibilities include:

- Reviewing the risk tolerance and risk limits
- Reviewing limits of authority delegated to management
- Systemic and procedural adequacy to identify, monitor, and manage risks
- Maintaining internal control system adequacy
- Compliance monitoring

The EMC meets monthly to provide policy-level and strategic direction for management of the energy supply portfolio (including PSE-owned or controlled resources) and to review and approve the acquisition or disposition of significant resources and contracts. The EMC receives monthly reports from Energy Operations with respect to the assessment and management of PSE's energy portfolio risks. The EMC Charter "*Charter*" details the membership, roles and responsibilities of the EMC. The EMC retains meeting minutes documenting decisions made. The EMC adopts, amends and oversees the *Procedures*. The EMC shall submit annually to the Board of Directors a report showing in reasonable summary the financial performance of the energy portfolio and giving a brief account of the energy supply related operations for the year in which the report relates.

2.3.4 VP of Energy Supply Responsibilities

VP of Energy Supply chairs the EMC and oversees Front Office and power/gas resource acquisition activities listed in section 4.1.

2.3.5 Senior VP and Chief Financial Officer Responsibilities

Senior VP and Chief Financial Officer is a member of the EMC and oversees Middle Office and Back Office activities described in section 4.2.

3.0 ENERGY PORTFOLIO MANAGEMENT

3.1 Risk Management Objectives

PSE will manage its energy supply portfolios to achieve three primary objectives:

- Ensure physical energy supplies are available to serve retail customer requirements
- Manage portfolio risks to serve retail load efficiently while limiting undesired impacts or risks (Specific risks controlled by this *Policy* are maintained in Appendix A)
- Optimize the capacity value of PSE energy supply assets.

The Company is expressly not engaged in the business of assuming risk for the sake of earning speculative trading revenues. Therefore, wholesale market transactions will be focused on maintaining adequate energy supply for the Company's energy portfolio, reducing costs and risks where feasible, and reducing volatility in wholesale costs in the portfolio.

The Company will have resources and tools necessary to achieve these objectives. In order to manage risks effectively, PSE will enter into physical and financial transactions that are appropriate for the service territory of the Company and that are relevant to its electric and gas portfolios.

3.2 Procedures to Govern the Energy Risk Management Activities

The Company has developed, and the EMC has adopted, an Energy Supply Transaction and Hedging Procedures Manual ("*Procedures*") that provides the guidelines and processes, and identifies roles and responsibilities, required for the Company to manage its electric and natural gas supply portfolios. Pursuant to this *Policy,* the EMC is responsible for overseeing the implementation of, and conducting a periodic review of, those *Procedures, the sooner of annually or when a change is made to either document*. All activities governed by the *Procedures* shall be within the guidelines and limits of this *Policy*.

The *Procedures* define the risk measures to be used as part of the risk management process to measure and monitor market risk related to achieving the hedging and transaction objectives. These functions will be performed independently of the commercial personnel entering into transactions on behalf of the Company. Details of the credit exposure analysis and the Company's process for managing credit are detailed in a Credit Risk Management Policy (CRMP), which is incorporated into the *Procedures*.

3.3 Hedging and Transaction Strategies

The Company's hedging and transaction strategies are to be consistent with Company objectives. The strategies will rely on an analysis of demand and supply relationships, operational factors, professional judgment of PSE's employees, and risk analysis. PSE will engage in transactions to reduce risks and volatility in the electric and gas portfolios. PSE will also engage in transactions to take advantage of unused capacity in PSE resources where possible. Cost and reliability factors must be considered in hedging strategies. The Company's hedging activities will be aimed at mitigating risks from the Company's electric and gas portfolios, including risks inherent in operating PSE-owned or controlled resources, giving consideration to cost of hedges and lost opportunities, all intending to find a balance between price stability, risk mitigation, and efficient costs. Wholesale energy transactions will also be aimed at optimizing resource capacity not required at certain times to meet customer loads. Staff will document hedging and transaction strategies and will report on them to the EMC monthly.

3.4 Hedging Activities

For Hedge Accounting, the Energy and Derivative Accounting ("EDA") team is responsible for designating each transaction either as a derivative or as a contract subject to the Normal Purchase Normal Sale ("NPNS") exemption. The EDA team is responsible for accounting for transactions and preparing the associated derivatives assets and liabilities accounts.

On a quarterly basis, the EDA team reports Derivative MTM results and creates the associated journal entries.

3.5 Price Curves and Marking

For risk limit monitoring and management reporting purposes, all positions are marked against the price curve which determines the value of the underlying asset. The market price is established using published indices, forward curves, price quotes and market intelligence. For illiquid markets and time periods or where third party forward curves are not available, a model may be used to value a position subject to EDA independently validating the assumptions and outputs used to value positions.

4.0 FUNCTIONAL RESPONSIBILITIES

PSE has adopted a Three-Lines-of-Defense model. This model provides segregation of duties between operating groups and allows for proper, independent review and control of risk activities.

The three lines of defense are:

- First Line of Defense ("LOD1") – risk owners and managers in the Front Office, Resource Acquisition, and Natural Gas Resources groups.
- Second Line of Defense ("LOD2") – risk control and compliance personnel in the Middle Office and Back Office.
- Third Line of Defense ("LOD3") – risk assurance personnel in Internal Audit

4.1 LOD1 Responsibilities

LOD1 activities and responsibilities are conducted by members of Front Office, Resource Acquisition, and Natural Gas Resources groups. Those roles and responsibilities are noted below for each group.

4.1.1 Front Office

The Energy Supply Merchant ("ESM") organization, also known as the Front Office ("FO"), is responsible for:

(a) Identifying and quantifying the exposure within the Energy Portfolio;
(b) Making hedging strategy recommendations to the EMC;
(c) Implementing EMC-approved hedging strategies and executing related transactions;
(d) Managing energy supply costs;
(e) Managing commercial valuation and structuring models;
(f) Liaising with representatives of other PSE business units outside of ESM and entering deals in trading systems on behalf of other deal-making business units, such as Resource Acquisitions and Natural Gas Resources;
(g) Approving authorized traders and notifying ERC joiners/leavers/movers within the time frame specified in the *Procedures*;
(h) Fully documenting all trading related transactions initiated by Front Office within the system of record by the close of business on the same day the transactions are executed.

Further details on processes and activities carried out by LOD1 personnel, as well as controls, permissions, and prohibitions, are noted in the *Procedures*. All Authorized Traders who transact on behalf of PSE must operate within approved limits set forth in or pursuant to those *Procedures,* including any applicable credit or transaction limits. Front Office Management oversees compliance of their staff with this *Policy* and authorization as outlined in the *Procedures*. A failure to abide by such limits may subject such persons to disciplinary actions, up to and including termination

4.1.2 Resource Acquisition

Resource Acquisition ("RA"), manages long-term and capital resource additions to, or dispositions from, the Energy Portfolio, including negotiations and oversight in the acquisition of new generation resources and purchased power agreements. RA develops and implements acquisition strategies, issues RFPs, evaluates potential asset targets and shepherds acquisitions through commercial negotiations to closing. RA negotiates long-term power purchase agreements, which may or may not utilize a master agreement such as the WSPP agreement. In its structuring and origination responsibilities, RA:

(a) Is responsible for communicating transactions and acquisitions with ERC and ESM to facilitate portfolio integration and transactions are accurately reflected within the ETRM Systems.
(b) Is responsible to adhere to the transaction authorization process as outlined in the *Procedures (Section III - Transaction Control)* and coordinate new acquisitions and transaction amendments with ERC and ESM to evaluate various strategic, operational and financial risks prior to seeking EMC approval.
(c) Consults with, and obtains approval from, ERC for credit provisions of contracts.
(d) If considering a transaction that gives PSE the right to use, operate, direct others to operate, or control access to property, plant and equipment, RA should discuss and review the transaction criteria with EDA to determine the applicability of lease accounting.

If a long-term power purchase contract provides PSE control outside of voting rights, RA should discuss and review the transaction with EDA to determine the applicability of consolidation guidance.

4.1.3 Natural Gas Resources

Natural Gas Resources manages and implements strategy regarding natural gas resource activities for PSE, including Canadian and US pipeline rates and tariffs proceedings, resource planning and additions to PSE's Energy Portfolio. Staff in Natural Gas Resources ('NGR") is responsible for:

(a) Coordinating and communicating transactions and acquisitions with ERC and ESM via email to facilitate transaction capture within the ETRM Systems.
(b) If considering a transaction that gives PSE the right to use, operate, direct others to operate, or control access to property, plant and equipment, NGR should discuss and review the transaction criteria with EDA to determine the applicability of lease accounting.

4.2 LOD2 Responsibilities

LOD2 activities and responsibilities are conducted by members of the Middle Office and Back Office. Those roles and responsibilities are noted below for each office.

4.2.1 Middle Office

The Energy Risk Control ("ERC") organization, also known as the Middle Office ("MO"), is responsible for:

(a) Managing risk control and credit functions such as independently monitoring, measuring, and reporting official risk positions, and monitoring compliance in accordance with the Energy Supply Transaction and Hedging Procedures Manual.
(b) Reporting the physical and financial positions and exposures of the Energy Portfolio and monitoring transaction activity within the limits approved by EMC
(c) Tracking the execution of EMC-approval hedging programs for the gas and power portfolios.
(d) Reviewing terms and conditions for master enabling agreements including WSPP, NAESB, ISDA, and others as well as provide commentary.
(e) Administrating enabling agreements for the purchase and sale of natural gas, master International Swaps and Derivatives Association (ISDA) agreements (including WSPP, electricity or other services), and forms of confirmations, as well as stand-alone physical energy supply and financial agreements, as well as pipeline contracts.
(f) Confirming that all executed transactions are captured into the appropriate ETRM systems, with all required details
(g) Implementing, updating, and assisting in maintaining data integrity within the ETRM Systems.
(h) Administering confirmations of power and gas transactions, verifying that unconfirmed transactions are addressed and resolved by PSE with counterparties consistent with underlying master agreements.
(i) Notifying the appropriate party of any known or suspected violation of the Energy Supply Transaction and Hedging Procedures Manual
(j) Issuing the official power and natural gas price marks.
(k) Maintaining relevant Sarbanes Oxley (SOX) Section 404 documentation.
(l) Reviewing, testing and implementing modeling assumptions for development of position and Exposure Reports and validating modeling effectiveness.

4.2.2 Back Office

The Energy and Derivative Accounting ("EDA") organization, also known as the Back Office ("BO") is responsible for:

(a) Monthly closing processes to ensure accuracy and completeness in gas, hourly bilateral and energy imbalance market (EIM) power and derivative transactions.
(b) Researching and communicating changes in derivative accounting policies and/or Variable Interest Entities (VIE) accounting to management and confirming compliance with Generally Accepted Accounting Principles (GAAP) standards and SOX controls and procedures.

(c) Developing, implementing and maintaining procedures for documenting trades/contracts that impact derivative accounting as well as maintaining documentation of derivative and VIE evaluations, all journal entries.
(d) Performing reconciliation with counterparty statements for power and natural gas accounts
(e) Monitoring internal controls and actively updating and performing SOX 404 procedures.
(f) Reviewing contracts on a monthly basis to determine the applicability of ASC 840 Leases and reviewing derivative implication ASC 815.
(g) Researching and implementing GAAP and SEC regulations that affect energy and derivative accounting or VIE.
(h) Resolving counterparty disputes in accordance with the defined Power and Gas Settlement Dispute Resolution Policy
(i) Following the settlement and payment schedules as defined by the California Independent System Operator (CAISO) including EIM related transactions.

4.3 LOD3 Responsibilities

LOD3 activities and responsibilities are conducted by members of Internal Audit. Internal Audit (IA) is responsible for conducting controls testing, opining on the design and operating effectiveness of controls and other risk framework elements, and providing assurance to senior management. IA is responsible for conducting and performing (or outsourcing) regulatory required audits for the business.

5.0 MARKET RISK IDENTIFICATION & CONTROL

PSE is active in the power and natural gas commodities markets. By participating in these markets, PSE is open to a variety of market-related risks. Risk management at PSE focuses on avoiding negative financial impacts and the practice of building a portfolio of positions that collectively meet PSE's objectives in accordance with EMC approved strategies. Accordingly, the Middle Office will aggregate, monitor, and own the reporting of the risks associated with all energy positions.

5.1 Market Risk Identification

PSE implements processes and procedures to identify and manage risks within hedging and trading operations.

Market risk is initially identified through pre-deal analysis. Once a position is established, the Front Office monitors changing market dynamics and identifies the impacts to the risk profile of the portfolio. The Front Office manages these risks using approved products and instruments while adhering to risk limits and hedging procedures as defined in the *Procedures.*

5.2 Operational and Financial Controls

The organization has developed a combination of operational and financial controls to maintain compliance with this *Policy*, regulatory requirements, and other guidance. Those controls are owned, conducted, and maintained by LOD1 and LOD2. LOD3 is responsible to test the controls and in case any discrepancies are identified, require LOD1 and LOD2 to implement new controls or amend existing controls.

Additional details of control activities contained in the *Procedures*.

5.3 Prohibited Transactions

A prohibited transaction is any transaction that is not expressly included on the approved list of transaction types in the DOA including commodity type, transaction type, exchange, tenor, volume, or counterparty. In the event approved transactions are considered abusive, or prohibited by regulators, exchanges, counterparties, or debt covenants, then the transaction is prohibited. Additionally, any speculative activities are explicitly prohibited.

5.4 Unauthorized Transactions

An unauthorized transaction is defined as any transaction that either:

- Results in an exceedance of portfolio-level risk limits
- Is entered into without the appropriate level of approval
- Is executed outside the commitment authority (exceeds or violates DOA)
- Is entered into with an unapproved counterparty
- Exceeds approved credit limits

5.5 Exposure Limits

Limits are important for monitoring the Company's transactions and hedging activities and are intended to control risks in the Company's energy portfolio. The EMC is responsible for setting and enforcing a comprehensive limits structure in the *Procedures*.

Specifically, the amount of risk exposure will be defined by time-period and by portfolio. It will be determined through statistical methods aimed at forecasting risk. ERC is to monitor the methodology for calculating risk exposure, and to propose to the EMC when new measurements may be appropriate. Because the Company is not engaged in entering into risk positions for the purpose of earning trading profits, the metrics the Company employs will be aimed at assessing exposure for the purposes of developing strategies to reduce the potential exposure on a cost-effective basis in regulated utility gas and electric portfolios. The EMC will adjust the metrics for potential exposure to be appropriate for the environment in which the Company is operating.

5.6 Structured Contracts Review

Structured contracts at PSE are any physical or financial contracts which: a) are not exchange-traded, b) possess fixed or variable price risk over one month in duration, or c) include physical or financial optionality. This may include Power Purchase Agreements (PPAs), off-take agreements, or non-standard transactions.

These deals require pre-deal analysis of key market, operational, credit, regulatory and accounting risks prior to being executed as defined in detail in the *Procedures*.

6.0 RISK MONITORING AND REPORTING

ERC is accountable for monitoring, and reporting risks, including new and emerging risks, and any known violation of a policy, procedure or regulation, to EMC in accordance with the escalation provisions of the applicable policies and procedures.

6.1 Market Risk Limit Monitoring and Management Reporting

EMC oversees the measurement of risk, compliance, and performance of hedging activities and will receive regular reporting. On a monthly basis, ERC prepares management reporting of the performance of hedging strategies and risk exposures for the EMC.

6.2 Market Risk Reporting

ERC measures and reports on the Company's risk profiles (inherent/residual) and portfolios on the daily, weekly and monthly basis. The primary purpose of risk reporting is to report on market and credit risk positions for compliance relative to the Company's risk limits. The Risk Management produced reports will be considered the report of record and will be reviewed by the EMC.

Tasks and Objectives
Where standardized reports are generated by an EOD batch process, while other business functions may be responsible for ensuring the successful generation and delivery of those reports, ERC must:

- Ensure the validity of input data - market data and forward curve structure, and
- Ensure the results of the valuation and risk calculations

7.0 REGULATORY COMPLIANCE

PSE and its personnel are subject to various laws and regulations in the jurisdictions we operate. Violations of these laws and regulations subject PSE and its personnel to serious consequences. All personnel must act in a manner which complies with this *Policy*, applicable laws and regulations, and our Code of Conduct. The trade surveillance program at PSE is managed by Front Office Compliance and ERC. ERC is responsible for confirming the sufficiency of existing controls. The program includes responsibilities for the monitoring, identifying, and validating exceptions.

7.1 Trade Surveillance

Trade Surveillance involves monitoring of trading activities and Prohibited Transactions for indications of misconduct. Scope of data surveillance activities include review of trade and transactional data and electronic and audio communication. Under each category, different data points shall be monitored, and various sampling methods of data should be employed.

7.2 Responsibility for the Monitoring

a) Front Office Compliance team maintains responsibility for operating and tuning the monitoring and surveillance tools and ensuring accuracy and completeness of issues management

b) The ERC is responsible for assisting in validating issues and in determining the path forward for confirmed exceptions

7.3 Exception Identification and Validation

a) Surveillance includes identifying and investigating issues raised by the trade established process and tools that are used for monitoring. This may include the disposition of "False Positives"
b) All findings require investigation, documentation, and analysis
c) Unresolved issues must be reported to EMC by Front Office Compliance.

8.0 POLICY ADMINISTRATION

The primary responsibility for the administration of this *Policy* rests with the EMC. Violations of this *Policy* and the *Procedures* may result in disciplinary action up to and including termination of employment or service contract. If staff become aware of a violation of this *Policy* or any *Procedures* that is not mitigated within the required time-period referenced in the *Procedures*, it must be brought to the attention of EMC.

8.1 Communication and Training

Within ESM, there is a dedicated team of Front Office Compliance personnel, which is responsible for the delivery of training to the business and tracking of attendance. The training responsibilities include key activities described in this *Policy* and any applicable regulatory or operational requirements. As changes to this *Policy* are approved and implemented, Front Office Compliance will provide communication to applicable personnel of the *Policy* change, the effective date of the change, and will deliver any required training associated with the *Policy* change prior to the effective date of the change.

8.2 Policy Exception

Exceptions to this *Policy*, by actions or failures to act, may increase PSE's market risk exposure beyond a level which was intended by management. Any exception to this *Policy* requires the authorization of the EMC.

8.3 Policy Violation Escalation

The risk governance structure is designed to control business activities and manage market risk exposure within a defined tolerance. Violations are classified into two categories: Limit violations caused by market movement and *Policy* violations. If violations of limits exceed the Authorized Trader's authority, and are not mitigated within the required time frame specified in the *Procedures*, ERC will notify the EMC. If the violation is not corrected, or if there is not a valid reason for the exception to the limit, the EMC will determine the management and disposition of the position. Violations of this *Policy* must be escalated in accordance with Escalation Procedures as defined in the *Procedures*.

8.4 Policy Authorization

This *Policy* is reviewed on an annual basis or as material changes to the business occur. The ERC is responsible for reviewing all recommendations for amendment, and upon satisfactory review, recommending approval to the EMC.

9.0 POLICY ACKNOWLEDGEMENT

All applicable PSE personnel shall acknowledge, in writing or electronically, their understanding and acceptance of this *Policy* annually. By acknowledging this *Policy*, it is expected that each individual is also acknowledging the supporting documents listed in Appendix A. Transaction authority will not be granted or may be revoked until written acknowledgement of this *Policy* has been received.

10.0 CONFIDENTIALITY

This document and the *Procedures* are confidential and intended for the sole use of PSE staff and its related entities. These documents contain proprietary information belonging to PSE and must not be wholly or partially reproduced nor disclosed without prior written permission from PSE Legal. Outside distribution is strictly prohibited unless as required for legal, regulatory, or audit requirements.

11.0 TRADING PROHIBITIONS

PSE employees are prohibited from engaging in trading for personal gain in any transactions in financial, natural gas or electric commodity markets. Questions with respect to the enforcement of this provision will be addressed by the Ethics and Compliance Officer or the EMC.

12.0 NEW REGULATIONS

If new accounting, regulatory or tax provisions would negatively impact transaction and hedging strategies or objectives for PSE, the EMC may address such issues by appropriately amending the *Procedures*.

13.0 APPENDIX

- Appendix A - Risk Definitions

Appendix A - Risk Definitions

The focus of this policy is the following risks:

Market Risk

Market risk is the risk of financial losses to the portfolio caused by adverse price movements. This can be due to exposure to movements in commodity prices, volatilities, and correlations. Within market risks there are static and dynamic risks.

Static risks are linear exposures to movements in underlying energy prices where volumes are constant. PSE will measure its static market risk using mark-to-market (MtM) and potentially value at risk (VaR) measures. Dynamic risks are characterized by optionality. PSE will quantify dynamic risks using the "Greeks" which measure the dynamic risk due to the change of the underlying commodity.

Asset Operations Risk

Asset operations risk is the risk associated with an asset's inability to perform as planned. An example of this risk is a forced outage, such as an unplanned reduction in capacity due to mechanical failure or external events at an industrial plant or logistical terminal.

Liquidity Risk

Liquidity risk is the risk that can occur due to some markets being illiquid or becoming illiquid during times of uncertainty. As such, PSE may not be able to liquidate or hedge its positions quickly in these situations. For markets that are illiquid, supplemental measures such as stress tests or scenario analysis may be required to accurately report the risk exposure to standard MtM and potentially 1-Day VaR. Where liquidity is low in certain segments of the markets or delivery periods, there will be a control, in the form of exposure limits, which prevent risk concentrations from building in any one segment of those markets.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events occur due to inefficiencies that may cause transactions to be lost, delayed, or processed incorrectly. Operational risk also encompasses fraud risk arising from purposeful concealment, mis-valuation, and the failure to record or incorrectly represent positions in internal or external systems.

Model Risk

Model risk is defined as the risk that potential errors or inappropriate actions or decisions are made based on models which are:

- Incorrect (e.g., uses a poor methodology or theory, contains implementation errors, developed errors during a change or update, etc.);
- Mis-specified (e.g., uses bad data, improperly calibrated, out-of-date training data set, etc.); and / or
- Misapplied (e.g., a sound model is used for an inappropriate task, user error, misinterpreted results, etc.)

PSE has established a separate Model Risk Management Policy governing the utilization of key financial and volumetric models in support of the business.