BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 191

In the Matter of PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY PacifiCorp's 2008 Transition Adjustment Mechanism.	STAFF'S REPLY BRIEF

INTRODUCTION

Consistent with the briefing schedule in this proceeding, the Public Utility Commission of Oregon Staff (Staff) submits its reply brief.

As discussed in Staff's Opening Brief, Staff's remaining issues involve Staff's witness, Mr. Wordley's, proposed adjustment for the margin from wholesale market transactions not included in PacifiCorp's GRID power cost model or accounted for in customer rates ("margin adjustment") and agreement with the Industrial Customers of the Northwest Utilities (ICNU) proposed adjustment to recognize the correct amount of power costs in current rates.

The margin adjustment is proposed to correct a problem with PacifiCorp's power cost model, which attempts to simulate actual power system operation. The problem with PacifiCorp's power cost model is systematic and cannot be corrected within the current model or by stochastic power costs modeling. Staff identified this systematic problem seven years ago and has since proposed similar margin adjustments in all PacifiCorp rate proceedings that have included power costs. In all of those previous cases, the parties have resolved the issues with stipulations approved by the Public Utility Commission of Oregon (Commission).

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DISCUSSION

1. Staff's margin adjustment is necessary to correct a systematic failing of PacifiCorp's GRID power cost model.

The problem that Staff has identified with PacifiCorp's power cost model is that it does not capture anywhere near all of the expected and, then, actual wholesale sales and purchase transactions that occur on PacifiCorp's expansive power system, which has been paid for by rate payers. Staff's margin adjustment is measured from three years worth of data, the only available years when there is data both from a GRID forecast for a year and the actual power operations results for that year. The analysis demonstrates a systematic and significant modeling problem. The actual MWhs of short-term sales and purchases exceed forecast by nearly 300%. Looking at Staff/201, Wordley/3, you can see that in the three separate years of modeled and actual data. Purchases are an average of 370.2% above what was modeled and sales were 207.7% above modeled. Overall the average sales or purchases comes to 16,733,031 MWh (51,198,251 divided by 3 plus 49,199,936 divided by three all divided by two). To provide some perspective, the volume of sales or purchases omitted (from the GRID forecast) wholesale transactions equals in excess of 25% of the company's entire system load. *See* Staff/201, Wordley/3 and PPL/201, Widmer /5 – (16,733,031)/58,006,889) = .28 or 28% of system load**.** The margin adjustment has been calculated as the average of the three individual margin adjustments for the model years stated, on an Oregon allocated basis. Each model year's margin is the difference of the year's excess sales divided by excess MWh less the year's excess purchases divided by the excess MWh s purchased, times the average of that year's excess sales or purchases. Staff's proposed adjustment is $16.2 million and reflects Oregon's allocated share of this omitted margin.

2. PacifiCorp's use of other margin calculations is misplaced.

PacifiCorp responds to Staff's proposed margin adjustment with alternative calculations of its own. However, none of these calculations are relevant because they use years for which both a GRID forecast and actual data are not available (*See* PPL/208), or they use a different

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definition of margin – the company references the $/MWh margin on total short-term wholesale activity versus the relevant omitted wholesale transactions. *See* PPL/204, Widmer/18, lines 13-19.

3. <u>PacifiCorp has failed to refute Staff's adjustment.</u>

PacifiCorp contends that Staff's adjustment is not supported by substantial evidence in the record. *See* PacifiCorp Opening Brief at 14, lines 7-9. Staff adjustment was explained in direct testimony, supplemental testimony, and during cross examination at the August 20, 2007 hearing.[1] PacifiCorp has failed to refute the data or the accuracy of Staff's calculation. Furthermore, PacifiCorp did not provide a comparable or relevant calculation.

PacifiCorp purports to rely on "system balancing" to explain why its power costs model grossly under forecasts actual volumes of wholesale transactions. PacifiCorp implies, but fails to factually demonstrate, that positive margins cannot result from the "dynamic process" of system balancing. *See* PacifiCorp Opening Brief at 18, lines 1 through 19, line 2.

On the other hand, Staff's analysis demonstrates positive margins are not only possible, but are systematic. A positive margin is produced on the wholesale transactions not captured by the GRID model, because of the advantageous nature of the company's diverse and spread out power system, combined with the company's competent management and operation of the system. *See* Staff/100, Wordley/5, line 21 through Staff/5, Wordley/6, line 17; PPL/500, Apperson/1. Combining the information on PPL/500, Apperson/1 and Staff/201, Wordley/1 indicates that PacifiCorp's system balancing activity for 2006 yielded $25.6 million of positive margin as allocated to Oregon. ($26.6 million for "UE 170," which was for 2006 from Staff/201, Wordley/1, less $1.0 million from PPL/500, Apperson/1 for "Oregon Share" of "Arbitrage and Trading programs").

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[1] Staff responded in detail to every data request propounded by PacifiCorp.

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4. PacifiCorp's comparisons of Net Variable Power Costs (NVPC) in rates and actual results are diversionary and irrelevant to Staff's margin adjustment.

PacifiCorp's repeated use of comparisons between of NVPC in rates and actual results, and assertion that the company's power costs in rates are understated, does not provide any meaningful information relative to Staff's proposed margin adjustment. *See* PacifiCorp Opening Brief at 19, lines 3-16. PacifiCorp's total actual power costs are impacted by many random factors, such as weather, hydro levels, market power and natural gas prices, power plant forced outages, and system load. The variation of these important random variables is what will be addressed by stochastic power cost modeling. Contrarily, Staff's proposed margin adjustment addresses the systematic, non-random, positive margin produced by the ever-present, intrinsic advantageous characteristics of PacifiCorp's power system.

5. Staff's margin adjustment is unrelated to PGE and the Commission order in UE 180.

While Staff has proposed a margin adjustment for PacifiCorp in each of PacifiCorp's last six rate cases, Staff has never proposed a margin adjustment for PGE. Staff has concluded that PGE and PacifiCorp are in different situations regarding the capability of their power systems to systematically produce positive margins on the "additional" wholesale transactions not captured by their respective power cost models. *See* Staff/201, Wordley/1. Simply stated, PacifiCorp makes a positive margin and PGE does not.

In addition, Staff disagrees with PacifiCorp that the margin adjustment is in any way related to an extrinsic value adjustment. This point was demonstrated by Staff/202, Wordley/3. In PacifiCorp's rebuttal testimony (at PPL/204, Widmer/18-21), PacifiCorp suggests that different levels of resources and different levels of planned maintenance between the GRID filed and actual results, and updates of "as filed" GRID cause a mismatch of costs and benefits. These factors are "noise," and do not effect in any significant way the margin on wholesale transactions not included in GRID. Staff's exhibit demonstrates that all the "additional" MWh of energy to make "additional" sales not included in GRID is provided by the "additional" MWh of purchases

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not included in GRID. This exhibit also demonstrates the independence of the margin adjustment from any extrinsic value considerations, because extrinsic value comes from undispatched flexible power resources, not from wholesale sales and purchase activity.

In this case, Staff did not propose an extrinsic value adjustment for PacifiCorp, anticipating that the company will continue to pursue the development of stochastic power cost modeling. Because the Commission's order in UE 180 dealt with extrinsic value, and not margin, any suggestion of a comparable situation between UE 180 and UE 191 is incorrect. *See* Staff/200, Wordley/1, line 17 through Staff/200, Wordley/2, line 13; Staff/200, Wordley/3, lines 6-20.

6. Staff's margin adjustment is not poor regulatory policy.

PacifiCorp contends that Staff's margin adjustment is poor regulatory policy. However, Staff's margin adjustment is necessary to account for the systematic problem with the normalized regulatory paradigm. When a systematic problem exits, it should be addressed.

PacifiCorp's contention that Staff's margin adjustment is not valid because Staff did not consider such things as new resources not yet included in rates, is incorrect. *See* PacifiCorp Opening Brief at 20, line 17 through 21, line 17. Staff demonstrated the insignificant impact of new resources not yet included in rates. I, including the resources PacifiCorp identified as not in rates, changes Staff's adjustment from $16.2 million to $15.8 million. *See* Tr.[2] at 125, line 14 through 126, line 4.

7. Staff supports and agrees with ICNU's proposed adjustment to reflect the correct amount of NVPC in current rates.

Staff agrees with ICNU's interpretation of the appropriate base for net variable power costs (NVPC) in this docket. Docket No. UE 170 yielded an undisputed $215 million Oregon allocated NVPC. *See* ICNU/116, Falkenberg/1; s*ee also* ICNU/100, Falkenberg/2. The addition of the $10 million that PacifiCorp received from UE 179 produces a current level of NVPC in

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[2] "Tr." refers to the official transcript of hearing held on August 20, 2007.

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rates of $225 million, which is the appropriate base from which to determine any change in UE 191.

ICNU is correct when it states that the total system NVPC of $834.4 million in the UE 179 stipulation "really served no purpose, other than to determine whether the $10 million increase was going to be granted or not" (Tr. 69; ICNU/100, Falkenburg/5). Order No. 06-564, Appendix A, Exhibit A, illustrates that the $834.4 million total system NVPC was only used to determine the $10 million NVPC increase cap. Note that the estimated 26.40% Oregon allocation factor in the Exhibit is incorrect; the actual factor was 26.06% or 0.2606; (PPL/101, Kelly/1) "Oregon UE-179 Net Power Cost" of $217,479,553 divided by "Total Company Net Power Cost" of $834,400,000. If the $834.4 million would have been used to determine the total NVPC to be allocated to Oregon, instead of being used just to determine the increase, then the Oregon allocated NVPC would have been $217.5 million (UE Oregon allocator of 0.2606*$834.4 million), instead of the $225 million the company received. *See* PacifiCorp Opening Brief at 23, lines 10-23.

In this proceeding, PacifiCorp argues that it should continue receiving this additional $7.5 million per year ($225 million less $217.5 million) by using the incorrect (lower) $217.5 million NVPC as the base for "NVPC in rates." Staff agrees with and supports ICNU's proposed $7.5 million adjustment, which will account for the correct NVPC in current base rates and allow for the appropriate reflection of the impact of a lower allocation of power costs to Oregon in UE 191 because of the continuing higher load growth in Utah.

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CONCLUSION

Staff respectfully requests that the Commission adopt Staff's margin adjustment. If the Commission wishes to provide PacifiCorp an incentive to continue its prudent operation of its advantageous power system, Staff requests the Commission adopt a sharing of Staff's margin adjustment. Staff also respectfully request that the Commission adopt ICNU's proposed $7.5 million adjustment for NVPC in rates.

DATED this 17th day of September 2007.

Respectfully submitted,

HARDY MYERS
Attorney General

s/Jason W. Jones ________________
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CERTIFICATE OF SERVICE

I certify that on September 17, 2007, I served the foregoing upon all parties of record in this proceeding by delivering a copy by electronic mail and by mailing a copy by postage prepaid first class mail or by hand delivery/shuttle mail to the parties accepting paper service.

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