BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 245

In the Matter of UE 245 PACIFICORP dba PACIFIC POWER 2013 Transition Adjustment Mechanism	STAFF POST HEARING BRIEF

I. INTRODUCTION

On August 31, 2012, Administrative Law Judge, Shani Pines, stated that, in addition to briefing the issues on each party's positions, the Public Utility Commission of Oregon (Commission) desired four issues be included in parties post-hearing briefing. Staff will first respond to the Commission's four questions. Then, Staff will explain why market caps should be removed from the Company's Generation Regulation Initiative Decision Tools (GRID) results and why planned outage modeling for all plants should be changed in the next Transition Adjustment Mechanism (TAM) filing.

II. DISCUSSION

1. A review of the purpose and execution of the TAM to present, to put into context the current TAM filing.

The primary purpose of the TAM is to establish transition charges or transition credits for direct access pursuant to ORS 757.607. However, the TAM also reduces regulatory lag and risk by allowing Pacific Power to update the net variable power costs included in rates between general rate cases, which results in a closer matching of actual power costs and the power costs included in rates and, therefore, likely a closer matching of actual earnings and authorized earnings.

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2. <u>A discussion of the reasons that Pacific Power has asked for an increase in rates every year since the TAM was introduced.</u>

There could be many reasons that Pacific Power has asked for an increase in rates every year since the TAM was introduced, such as but not limited to, coal prices, lower market prices, lower dollar value of sales credits, or reduced hydro. The Public Utility Commission of Oregon (Staff) notes that the Company is currently requesting, in its July Update to the 2013 TAM filing, an increase of less than one percent in unit net power costs (NPC) over the final 2012 TAM filing, or an NPC-related increase in overall Oregon customer rates of less than 0.3 percent. Also, actual unit NPC for the first six months of 2012 are slightly <u>lower</u> than the final 2012 TAM unit NPC forecast. Therefore, the five-year period from 2007-2011 might not be representative of current and future conditions.

One reason that Pacific Power has asked for an increase in rates every year since the TAM was introduced is increased coal costs. Per MWh coal costs are approximately $4.00 per MWh higher in the 2013 (test year) TAM than in the 2009 TAM. This translates into approximately $170 million in net power costs on a system basis, or $42 million on an Oregon-allocated basis. This explains more than one third of the increase over this four year period. Pacific Power's final November TAM filings have positive net market-priced sales. All other things equal, this has contributed to increased TAM requests, as market price forecasts, and hence the value of this GRID-modeled surplus of market-priced sales over market-priced purchases, have steadily decreased over the past few years. Decreases in expected output from the Company's own hydro facilities, as well as contractually-based decreases in output from the Mid-Columbia hydro plants, have also contributed somewhat to increased TAM requests.

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3. A discussion of the factual conflict in the parties' testimony regarding whether arbitrage sales are modeled in GRID.

Staff understands that the Company included this adjustment in GRID through its 2012 TAM filing. The Company then discontinued the adjustment in its 2013 TAM filing.[1] Had the Company included the adjustment in its 2013 TAM filing, the effect would have been a decrease of $2.5 million in the system-wide NPC forecast.[2]

4. A discussion of Pacific Power's admission that GRID has understated Pacific Power's NPC in rates every year since the inception of the TAM. Given Pacific Power's admission, on what basis should the Commission find that GRID is accurate, or should the Commission conclude that GRID does not accurately model NPC in rates?

Table 8 of Pacific Power's UE 246 Exhibit PAC/900 provides a summary of GRID's performance for the five years between 2007 and 2011. In each of those years, GRID underestimated NPC. The table below provides percentage measures of these underestimations, i.e., underestimation amount divided by actual NPC.

Year	Error Size	Error Type
2007	11.5 %	Underestimate
2008	10.8 %	Underestimate
2009	3.0 %	Underestimate
2010	11.9 %	Underestimate
2011	9.7 %	Underestimate
Average	***9.4 %***	***Underestimate***

[1] *See* Exhibit PAC/100, Duvall/22.
[2] *See* the Company's Revised Response to Industrial Customers of Northwest Utilities (ICNU) Data Request 2.14, provided to parties on August 7, 2012, ICNU Cross Exhibit/200.

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Staff has not audited or reviewed Pacific Power's actual power costs. GRID forecasts normal power costs (i.e., normal hydro, normal temperature loads, normal forced outage rates, forward prices, etc.). The difference between GRID's normalized power costs and actual power costs can logically be explain by deviations from normal inputs. Deviations from normal are expected and not a concern. However, any remaining difference after accounting for deviations from normal inputs is a concern.

Backcasting is one approach to separating the deviations between forecast and actual NPC into two components, one due to deviations from normal hydro, normal forced outage rates, forward curve-based market gas and electric prices, etc., the other due to model logic and design. Again, the latter is the area of potential concern. If GRID performed well in backcasting exercises, then parties would be more assured of its quality. If GRID performed poorly, then parties might want to consider solutions such as significantly modifying GRID, or adopting a different model. However, backcasting has not been tried and would be very time intensive. There is also the possibility that parties would spend considerable time and effort in backcasting, only to reach unclear or controversial results.

<u>MARKET CAPS</u>

1. <u>The issues that the Company raised at the hearing are not relevant to Staff's recommendation on eliminating market caps from the Company's GRID modeling.</u>

Market caps were at issue in Docket UE 227, the 2012 Transition Adjustment Mechanism (TAM) proceeding. In Order No. 11-435, the Commission accepted the Company's methodology on a non-precedential basis and directed Staff to organize one or more workshops for parties to discuss the issue and, if possible, come to agreement on a market cap methodology. The Commission also stated that "If no agreement can be reached, we will expect Pacific Power to provide clear and robust evidence justifying its modeling of market caps in the Company's

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next TAM proceeding. We will also ask Staff to present in the next TAM docket its own technical analysis of this issue."[3]

Staff hosted a workshop on January 11, 2012. Representatives of the Industrial Customers of Northwest Utilities (ICNU) suggested one possible approach to the issue of market caps. However, it was made clear that ICNU did not necessarily support this approach and that considerable analytical work would be necessary to develop a concrete proposal for consideration.[4] The Parties then agreed that it was not possible to reach agreement at that time and that they would present their analyses and recommendations in the 2013 TAM proceeding, i.e. this docket.

Given the Commission's direction that Staff "present in the next TAM docket its own technical analysis of this issue," Staff began its analysis in this docket "from scratch." Staff's testimony in this Docket is did not rely at all on Staff's testimony in Docket UE 227, particularly Page 5 of Exhibit Staff/100 in Docket UE 227, which comments in part on depth or liquidity in particular markets.

Pacific Power has also entered into the record in this docket Staff's testimony in Docket UE 250, in particular Exhibit Staff/100 in that Docket.[5] That testimony, in part, concerns liquidity in gas hedging or forward markets relevant to Portland General Electric Company (PGE) and it is not related to this docket. In this docket, some parties, most notably the Company and ICNU, have discussed liquidity in real-time electric markets at certain locations. However, Staff has not discussed liquidity in real-time electric markets in this docket. Staff's comments in UE 250 again are not related to this docket, as they concern gas, rather than electric, and forward, rather than real-time, markets relevant to PGE, rather than to Pacific Power.

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[3] *See* Order No. 11-435 at 23.

[4] Staff did implement the analytical approach suggested by ICNU. It forms the basis for Staff's alternative recommendation. *See* Staff/100; Schue/16-18

[5] *See* Exhibit PAC/401.

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2. Market Caps should be eliminated in the Company's GRID modeling, resulting in a decrease in system-wide net power cots (NPC) of $15.5 million, or appropriately $3.9 million on an Oregon allocated basis.

The Company applies caps based on four-year average historical data, the same average historical sales level being applied as a cap to market sales in every hour (for each trading hub, each month, and differentiated by on- and off-peak hours) in GRID.[6] This is inconsistent with both actual historical and uncapped GRID sales figures, both of which show great variation across hours. The Company's construct thereby cuts off some potential sales with positive margins. These positive margins then do not get credited to customers in GRID, resulting in a $15.5 million overstatement of expected NPC on a system basis, or approximately $3.9 million on an Oregon-allocated basis.[7]

For context, if GRID sales were the same in each hour, and equal to the market caps for each of the on- or off-peak monthly periods at each of the six trading hubs, overall annual sales would be approximately 20,000 GWh.[8] In the Company's initial filing, uncapped GRID sales are approximately 13,200 GWh, whereas capped GRID sales are approximately 10,700 GWh.[9] These figures are in the context of the Company's system-wide load of approximately 60,000 GWh.[10]

The Company makes various assertions supporting the idea that uncapping sales in GRID leads to large differences between actual experience and GRID results.[11] The above figures show that the Company's assertions are not true. In addition, the Company exaggerates its points, particularly in its graphical presentations – Figures 1 and 2 on Page 18 of Exhibit PAC/300 and Table 6 on Page 21 of Exhibit PAC/100. These graphs are all based on actual data

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[6] *See generally* Staff/100; Schue/5 at 5-6.
[7] *See* Id at 5-16.
[8] *See* Id. at Schue/7, line 7.
[9] *See* Id. at Schue/6 at 21-22.
[10] *See* Id. at Schue/7 at 1-2.
[11] *See* PacifiCorp's Prehearing Brief at 11, Line 1.

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for only a 12- month period ending June 2011, rather than the 48-month period ending June 2011, which is the basis for the market caps.

In these examples, average sales in the 12-month sub-periods were substantially lower than average sales in the relevant 48-month periods – 32 percent lower at the Four Corners trading hub, and 40 percent lower at the California-Oregon Border (COB). The graphs then incorrectly show GRID capped sales being greater than actuals, which would be impossible if the relevant 48-month actual data were used. GRID capped sales can never, in any hour, be greater than the cap, which is the 48-month average of actuals. Since GRID capped sales will sometimes be less than the cap, overall GRID capped sales should be shown as less than actuals. The graphs also present an incomplete picture of the relationship between capped and uncapped GRID sales. At these particular trading hubs, uncapped sales are substantially greater than capped sales. However, on an overall system basis, capped sales are approximately 10,700 GWH and uncapped sales are approximately 13,200 GWh, as noted above. This difference of approximately 2,500 GWh is only approximately four percent of the Company's system load. Note that this 2,500 GWh figure is a system-wide measure. The Company's statement that it is an Oregon-allocated figure is incorrect.[12] Therefore, the Company's comparison of the 2,500 GWh system-wide figure with an Oregon industrial load figure of 2,300 GWh is a mismatch between system-wide and Oregon measures.[13]

Market caps also introduce year to year volatility into GRID results. Market caps resulted in an increase in NPC of $5.5 million for the 2012 test period. However, caps increase NPC by $15.5 million, or almost three times as much, for 2013 in this docket.

PacifiCorp's argument that GRID has underestimated NPC in each of the five years from 2007 through 2011, and that therefore market caps should be retained because they decrease GRID's underestimation tendencies is not persuasive. The Company refers to data it provided in

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[12] *See* PacifiCorp's Prehearing Brief at 15, Lines 20-21.

[13] *See* PacifiCorp's Prehearing Brief at 16, Lines 1-4. *See* also Staff/100; Schue/6-7 for a general discussion of various system-wide figures.

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Docket UE 246 on differences between GRID forecasts and actual power costs.[14] While Staff believes that these summary figures are accurate, they do not justify an average historical data-based market cap structure, which is inconsistent with both actual and un-capped sales data. Moreover, the Company's unfavorable NPC results over the 2007-2011 period may not be representative of future periods. In fact, for the first six months of 2012, actual unit NPC were slightly lower than the GRID forecast for that same period. This further undercuts the Company's argument that summary 2007-2011 results justify market caps.

The Commission should eliminate market caps from the Company's GRID modeling because they are inconsistent with actual historical and uncapped GRID sales figures. This adjustment will result in a decrease in system-wide NPC of $15.5 million, or approximately $3.9 million on an Oregon-allocated basis.

If the Commission finds the Company's arguments for retention of market caps to be somewhat persuasive, Staff offers an alternative recommendation. The alternative proposal is based on Staff's implementation of the approach suggested at the January 11, 2012, workshop. Under this alternative, market caps are based on the highest of the four years of data, rather than the average of the four years (for each trading hub, each month, and differentiated by on- and off-peak hours).[15] This effectively loosens the caps to some extent, resulting in a $7.7 million system-wide reduction in NPC. If the Commission were to choose this alternative, it should also order the Company to reinstate its arbitrage and trading adjustment, which would further reduce system-wide NPC by $2.5 million. Staff supports the Company's elimination of the arbitrage and trading adjustment only in the context of also eliminating market caps, as they are both controversial adjustments to the basic GRID modeling structure. It would not be fair to eliminate the arbitrage and trading adjustment, which benefits customers, but retain market caps, which benefits the Company.

[14] *See* Exhibits PAC/900, Duvall/16 and PAC/1800, Duvall/12 in Docket UE 246.
[15] *See* Staff/100, Schue/16-18

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3. Planned test year outages for all plants and hydro forced outage rates.

Staff incorporates the comments from its prehearing brief and recommends that 1) Staff withdraw its recommended disallowance of $2.6 million related to planned hydro plant outages for the 2013 test period, and 2) the Commission direct the Company, beginning with its 2014 TAM filing, to begin using planned test year outages for all plants in its GRID modeling. This will provide the most accurate test year NPC forecast possible, which will then be compatible with Staff's recommended PCAM structure in Docket UE 246.

III. CONCLUSION

For the foregoing reasons, Staff requests that the Commission order the Company to remove the effect of market caps from the GRID results and include planned outages for all plants in in its next TAM filing.

DATED this 14th day of September 2012.

Respectfully submitted,

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