MEMORANDUM

TO:COMMISSIONER HANSEN

COMMISSIONER NELSON

COMMISSIONER SMITH

BILL EASTLAKE

FROM:SCOTT WOODBURY

DATE:NOVEMBER 30, 1998

RE:CASE NO. WWP-E-98-4

WWP PETITION TO TERMINATE PCA

On April 1, 1998, The Washington Water Power Company (Water Power; WWP; Company)  filed a Petition in Case No. WWP-E-98-4 for an Order terminating its Commission approved Power Cost Adjustment (PCA) mechanism.

Water Power’s PCA is used to track changes in revenues and costs associated with variations in hydro electric generation, secondary prices, and changes in power contract revenues and expenses.  The Company’s PCA mechanism was first established in Case No. WWP-E-88-3, Order No. 22816 issued October 31, 1989 and has been extended, modified and clarified in a number of subsequent cases (WWP-E-93-3, Order No. 24874; WWP-E-94-4, Order No. 25637; WWP-E-97-10, Order No. 27202).  Tr. pp. 82-84.  Since its inception there have been six rebates totaling $14,961,000 and three surcharges totaling $6,769,000, a difference of $8,192,000.  Tr. p. 125.

The Company in its Petition cited two reasons for requested termination:

1.The PCA mechanism over-values surplus hydro generation during high stream flow periods.

2.The PCA is only approved in the state of Idaho which represents only 31.40% of the Company’s total electric power cost.

The Company in its Petition proposed to allow two existing authorized rebates to continue until expired (May 31, 1998 and August 31, 1998, respectively) and to reverse the accrued deferred rebate balance in the PCA balancing account.  Tr. p. 90.  At March 31, 1998, the deferred rebate balance in the balancing account amounted to $4,797,000.  (At June 30, 1998, the deferred rebate balance was $1,578,000.  (Tr. p. 90.); at October 31, 1998, the deferred rebate balance was $3,891,732 (Exhibit 10).)  Under the Company’s proposal, no true-up would be made for any over rebated or under rebated amounts.

Although the Company requested that its Petition be processed pursuant to Modified Procedure (i.e., by written submission rather than by hearing), the Commission determined that a formal hearing was required.  A public hearing in Case No. WWP-E-98-4 was held in Boise, Idaho on October 28, 1998.  The following parties appeared by and through their respective counsel:

Water PowerDavid J. Meyer

Commission StaffScott D. Woodbury

Idaho Power Companyno appearance

Although the Company’s Petition requested termination of the PCA, in its testimony filing Water Power proposed two changes to the PCA methodology that it contended would make it acceptable:

1.Formulaic “fix” to correct over valuing of surplus hydro generation (HLH / LLH pricing problem)

The secondary price in the PCA model is calculated based on all of the Company’s real time sales and purchases and also the block trading that happens at the Mid-Columbia and California-Oregon border.  The majority of real time trading and most block trading is for heavy load hour (HLH) energy (6 a.m. - 10 p.m., Monday - Saturday).  Tr. pp. 16, 20.  If the load shape of the secondary energy price is more weighted towards heavy load hours than the hydro surplus hydro generation (the amount of hydro generation greater than the level authorized in the PCA model) then the PCA model will over-value the surplus hydro generation.  Tr. p. 14.  Based on Water Power’s historical records, heavy load hour generation is typically 3-4 mills more valuable than light load hour (LLH) generation.  (Compare times in 1996 and 1997 when difference was over 10 mills.)  Tr. pp. 22, 72.

2.Eliminating the 80% / 20% adjustment for difference between actual and authorized secondary energy prices.

Water Power recommends eliminating the 80/20 adjustment for two reasons:  (1) the liquidity and efficiency of the energy markets limits the ability of the Company to influence price (Tr. pp. 31, 53, 54); (2) recent changes in how the river flows are managed tends to create greater deviations between actual and authorized hydro generation and secondary energy price.  (Tr. pp. 32, 54, 55).

Tr. pp. 32, 33, 92, 93.

As reflected at hearing and in changes to its prefiled testimony, Commission Staff after reviewing the Company’s rebuttal testimony now agrees with the proposed Company changes to the PCA methodology.  Tr. pp. 5, 6, 131, 136.  Staff recommends continuation rather than termination of the PCA.  Tr. p. 6.  With Staff’s support of the two elements of the Company’s proposed PCA fix, the Company states that it no longer proposes to terminate its PCA, but instead prefers to leave the PCA in place.  Tr. pp. 67, 118.  The value of the PCA, the Company states, is that it is still a hedge against conditions the Company cannot control, being hydro generation and price and the variations that can cause it, so in effect the PCA can moderate swings in the Company’s costs.  Tr. p. 68.  The PCA is also recognized to be of continued value to the Company’s customers.  Tr. p. 71.

The remaining contested issue in this case is with respect to what amount, if any, out of the accrued deferred rebate the Company should be entitled to keep.  Tr. p. 6.  The deferred rebate balance at October 31, 1998 was $3,891,732.  Exhibit 10.  The Company proposes an adjustment to the balance in the amount of $669,000 derived as follows:

PCA mechanism over values “surplus” hydro generation during high-stream flow periods resulting in additional rebate deferrals (Tr. p. 14):

1996$587,388 Exhibit 5

1997$450,437 Exhibit 4

PCA model over values the cost of purchasing energy in years with low hydro generation and therefore increases the size of the PCA deferrals in the surcharge direction (Tr. p. 26):

1992($242,164) Exhibit 6

1994($125,978) Exhibit 7

Total$669,683

Tr. p. 98 .  Staff continues to oppose reversing the balance in the PCA deferral account or reversing any portion of the balance in that account.  Tr. pp. 6, 119, 124.

The adjustment proposed by the Company for 1992, 1994, 1996, and 1997 is related only to the HLH / LLH pricing differences the Company proposes to add and not the 80% / 20% market price adjustment that the Company proposes to eliminate.  Tr. p. 74.  Water Power contends that in recognizing HLH / LLH pricing differences it is not proposing a change in the PCA calculation.  The adjustment, it states, does not change the amount of resources that are sold, nor does it change how resources are dispatched, but instead more accurately values the hydro generation that is above or below authorized levels.  Tr. p. 36.  The reduction in the balancing account the Company is requesting, it states, is not a “substantial change” in the PCA methodology but is based rather on a “correction” or “refinement” for conditions that were not envisioned when the PCA methodology was established, i.e., that the amount of wholesale trading would exceed the Company’s retail load obligations; that the vast majority (80%) of all energy trading would occur in a standard product, on-peak 25 megawatt blocks; nor that energy trading would go beyond utility to utility trading.  Tr. pp. 38-40, 46, 60, 75, 76, 103.  Because of the volume of this on-peak trading the average secondary price calculated for the PCA, the Company states, is heavily weighted to on-peak rates.  This, it contends, has resulted in the PCA methodology over-valuing surplus hydro generation and over-valuing what it costs to replace below authorized hydro generation.  The Company states that it seeks only to correct for an inaccuracy that was not foreseen when the PCA was established.  Tr. p. 46.  The HLH / LLH pricing difference, the Company contends, is not dissimilar to the issue of excluding Palo Verde trading from the secondary price calculation, which it argues was predominantly on-peak trading and also caused the secondary price to be heavily weighted to on-peak prices.  Tr. pp. 39, 40.  (Reference Order No. 27207, Case No. WWP-E-97-10, adjustment to exclude Palo Verde trading

— “We find that the Company is not asking for a change in PCA methodology only a clarification. at p. 2; since the inception of the Company’s PCA methodology the electric industry has changed, as has the way WWP does business.  No longer are utility off-system sales reflective merely of sales of surplus generation from system resources.  No longer are power purchases made to simply serve system load requirements.  at p. 2; we find that the trading engaged and by the Company ‘was never envisioned’ when the PCA methodology was established and that it is reasonable to exclude same from the PCA secondary price calculations.  at p. 2; Water Power contends that it is appropriate to exclude Palo Verde trading because trading at Palo Verde consists of speculative wholesale transactions that have no connections to the Company’s system requirements or to its system resources and because prices at Palo Verde are not reflective of the load or resource conditions in the northwest or the value of surplus hydro generation.  at p. 1.”

An adjustment to the balance in the deferral account should be made, the Company contends, “to account for net rebate deferrals being over stated” ($369,000 dry years 92, 94 — surcharge deferrals to high; $1,038,000 wet years 96, 97 — rebate deferrals over stated. Tr. pp. 44, 58, 93, 101; Exhibit 8, $668,683.).

Contrary to the Company, Staff contends, that the correction for HLH / LLH pricing is a “substantial change” in PCA methodology.  The Commission’s Order establishing the PCA did not include any explicit heavy load/light load hour pricing differences.  Tr. pp. 57, 75.  Whereas speculative off system wholesale trading at Palo Verde did not exist prior to 1995, block trading at Mid-Columbia and COB existed in 1989 and there has always been a difference in heavy and light load hour pricing.  Tr. pp. 48, 62.  The difference in block trading and HLH / LLH pricing between 1989 and today is only one of degree.  The energy trading market today is more developed than in 1989 when the PCA was established.  Tr. pp. 52, 53.

In as much as Staff contends that the change in HLH / LLH pricing is a “substantial change” and “not a mere clarification,” Staff opposes any adjustment to accrued PCA rebate balances, amounts calculated pursuant to Commission approved methodology (Tr. pp. 57, 58, 132, 137); and in cross characterizes such an attempt to keep accrued rebate monies as breaking a compact with its customers and not giving them the benefit of the bargain.  Tr. pp. 114, 115; also 125.  It was noted that the Company had the option at any time during this case to file a motion asking for a stay of the PCA methodology accruals, and yet did not do so.  Tr. p. 116.  It was also noted that the PCA methodology was never intended to be an exact reconciliation of actual to authorized, but has always been simply an approximation.  Tr. pp. 64, 126.  (Reference Order No. 22816 at p. 21; “It allows a midcourse adjustment without regulatory lag which partially corrects for incorrect assumptions made at the time an authorized base power supply is established”.)  As an approximation and estimate it can always be further refined.

COMMISSION DECISION:

The expressed preference of the Company and Staff is to continue the PCA with HLH / LLH pricing change and elimination of the 80% / 20% adjustment.  Does the Commission agree that the PCA should be continued?  If not, what is the Commission’s preference?

Does the Commission view the proposed HLH / LLH pricing change and the elimination of the 80% / 20% adjustment to be substantial changes to the underlying PCA methodology or simply refinement and clarification?

With respect to the accrued rebate balance in the Company’s PCA account (October 31, 1998 $3,891,732) should the entire amount be rebated to customers?  Should the Company proposed adjustment ($669,00) calculated by applying the HLH / LLH pricing calculation to high water (1996, 1997) and low water (1992, 1994) years be approved?

Scott D. Woodbury

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