PGE Traders Burned by California Heat Wave

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By Robert Mullin

Portland General Electric said Monday that that it suffered $127 million in losses from wholesale electricity trades because of recent volatility in the California energy market — a figure that is almost certain to rise.

PGE estimates the losses could undercut its 2020 earnings by as much as 48%.

"Certain PGE personnel entered into a number of energy trades during 2020, with increasing volume accumulating late in the second quarter and into the third quarter, resulting in significant exposure to the company," CEO Maria Pope said in an email to employees included in a *filing* with the U.S. Securities and Exchange Commission. "Simply put, these trades were ill conceived."

PGE attributed the losses to trading positions that went sideways during the recent heat wave that roiled *CAISO*'s market and caused supply shortages, driving up wholesale prices and creating constraints on regional transmission. The shortages prompted the ISO to order rolling blackouts in California for the first time since the energy crisis of 2000/01 and temporarily suspend its convergence bidding market. (See *CAISO Provides More Details on Blackouts*.)

"As a result of the convergence of these conditions, the company's energy portfolio, as of Aug. 24, 2020, has experienced realized losses of $104 million and unrealized, mark-to-market losses of $23 million," PGE said. "Total third-quarter losses in the portfolio are estimated to be up to $155 million subject to market conditions — although the ultimate amount of losses could exceed that amount."

PGE on Monday moved quickly to contain potential political damage from the incident, saying it had placed two unnamed staff members on administrative leave pending further review. It also assured customers that it would not seek to recover the losses through increased rates.

PGE wind farm in Eastern Oregon | *Sherman County Government*

The utility also announced the formation of a special committee consisting of five independent board members to examine the events leading to the losses and review existing procedures and controls. The company has additionally engaged external consultants "to perform a full operational review of our energy supply risk management policies, procedures and personnel," Pope said.

She also said the company would not be adjusting its 2020 and 2021 capital and operational budgets and assured employees that "we do not anticipate any layoffs as a result of this situation."

"This situation is not reflective of who we are at our core, and we will learn from the situation and make the necessary changes to ensure this will never happen again," Pope said.

Black Swan?

While PGE has not disclosed the exact cause of the losses, their sheer size — and the utility's response — suggest the trading activity leading to the losses fell outside expected norms.

"The way Pope worded it — 'ill-conceived' — makes me think it's something nonstandard," said a compliance analyst with another Northwest utility who asked not to be named.

The analyst also questioned how traders could build up such exposure under a standard protocol of daily trading and position limits.

"I know we have significant risk controls. But I don't really know what kind of trading led to the losses," the analyst said.

Portland-based energy economist Robert McCullough pointed to the potential impact of CAISO's convergence bidding market on PGE's trading woes.

"The nature of a relatively unregulated pure derivative — like the convergence market in California — has an enormously asymmetric risk profile. In English, this means that a prudent trade, on rare occasions, can lose 50 times the expected profit," McCullough said.

He said CAISO's suspension of convergence bidding during the heat wave — right after the declaration of a Stage 3 emergency — indicates that market losses were high at the time and that manipulation was a possible explanation.

"PGE is hardly a high-risk trading operation," McCullough said. "A regional utility with substantial assets, they traditionally 'trade around assets.' I would suspect that the natural asymmetry of a black swan caught them off guard."

Even CAISO officials seem aware of the potential for convergence bidding to produce a "black swan" trading event.

During a CAISO stakeholder call Aug. 21 to discuss the recent blackouts, ISO Director of Market Analysis and Forecasting Guillermo Bautista Alderete said convergence bidding can add confusion to the market in times of short supply because convergence bids and physical supply are cleared on the same basis.

When there's sufficient capacity and supply, "the positions taken in the day-ahead market can be supported. However, when the system is constrained … the position parties can take can result in chaos," he said.