DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: LISA NORDSTROM

DATE: AUGUST 27, 2004

RE: IN THE MATTER OF THE APPLICATION OF AVISTA UTILITIES FOR AUTHORITY TO INCREASE ITS PURCHASED GAS COST ADJUSTMENT (PGA) RATE. CASE NO. AVU-G-04-2.

On July 23, 2004, Avista Utilities filed its annual Purchased Gas Cost Adjustment (PGA) Application with the Commission for authority to place into effect new rate schedules that will increase its annualized revenues by $7.8 million. Avista states that any increases resulting from this PGA filing directly results from the cost of gas purchased in the marketplace; Avista Utilities makes no additional profits from the PGA rate change. If this Application is approved, Avista states that Company revenues will increase by approximately 14.2%. When combined with the base rate increase requested in pending Case No. AVU-G-04-1, Company revenues could increase by approximately 22%.[1] Avista requests that the proposed PGA rates become effective on September 9, 2004 to coincide with the effective date of the base rates being considered in their general rate case.

The Commission issued a Notice of Application, Modified Procedure, and Comment Deadline on July 29, 2004. Order No. 29554. As of the August 26 comment deadline, the Commission had received comments from Staff and six Avista customers.

THE APPLICATION

Avista believes this Application should be approved because it purchases natural gas from a subsidiary of Avista Corporation, Avista Energy, under the provisions of Tariff Schedule 163 (the Natural Gas Benchmark Mechanism). Avista transports this gas over Williams Pipeline

[1] The 22% combined increase is comprised of a 14.2% PGA revenue increase in this case and the 7.82% base rate increase requested in the Company's rebuttal testimony filed in Case No. AVU-G-04-1.

West (d.b.a. Northwest Pipeline Corporation) and Westcoast Pipeline systems and defers the effect of timing differences due to implementation of rate changes and differences between Avista's actual weighted average cost of gas (WACOG) purchased and the WACOG embedded in rates. Avista also defers the revenue received from Cascade Natural Gas for the release of storage capacity at the Jackson Prairie Storage Facility, various pipeline refunds or charges, and miscellaneous revenue received from gas-related transactions.

Avista filed proposed tariff sheet 150, which increases the prospective natural gas cost component included in the rates charged to customers by 11.730 cents per therm. This requested rate change consists of a 10.750 cents per therm increase related to the (variable) commodity cost of purchasing and transporting gas for customer usage and a .980 cents per therm increase related to fixed pipeline costs.

The commodity cost increase is based on a proposed increase in the present WACOG included in the Company's gas service schedules. Gas prices have increased markedly since the fall of 2003. The Company's present WACOG included in its gas sales rates is 44.989 cents per therm, which was approved by Commission Order No. 29342. The WACOG proposed in this requested increase is 55.739 cents per therm, reflecting the first-of-the-month (FOM) forward gas prices as of July 13, and hedges executed to date. FOM forward prices, weighted by basin, are multiplied by the monthly projected load requirements, less volumes hedged to date. The Company has executed three hedges to date for the coming winter (November-March) at an average price of 58.4 cents per therm. Additional hedges will be executed prior to this winter, with total hedged volumes representing approximately 50% of the total annual projected load requirements for the July 2004-June 2005 period. Should future FOM or hedged prices substantially change the WACOG requested in this filing, Avista committed to revise this filing or submit an additional PGA filing to reflect those changes.

In this filing, Avista is <u>not</u> proposing to change the present amortization rate(s) set forth under Schedule 155. This amortization rate is used to refund or surcharge customers the difference between actual gas costs and projected gas costs (from the last PGA filing) over the past year. The Company has a deferred gas cost balance of approximately $3.3 million, as of June 30, 2004, reflecting higher gas costs than projected during the past year. However, the present amortization rate is a surcharge of 3.093 cents per therm, which would recover the present deferral balance over an approximate 18-month period. The Company believes this estimated recovery period is reasonable and, given the substantial increase proposed in the WACOG, is not proposing a change to the amortization rate.

If the Commission approves the proposed increase, firm sales customers on Schedules 101, 111,112,121 and 122 will see a rate increase of 11.730 cents per therm. Interruptible sales customers on Schedules 131 and 132 will see a rate increase of 10.750 cents per therm. The Application presumes that upon completion of this PGA tracker case, the Company's Tariff Schedule 150 will be changed to appropriately address both base rate and PGA tracker changes.

Avista is proposing that the large transportation and interruptible customers be given the option of receiving/paying their portion of the deferred gas costs either through a lump sum credit/charge or through an amortization rate. If these customers choose the lump sum method, Avista proposes to adjust these billings credits/charges by the amount of interest that accumulates from the end of the test period used in this filing to the date of actual settlement. This proposal would clear out the small residual balances related to interest charges that are carried forward between PGA filings for large customers.

If the Application is approved, Avista states that the Company's estimated annual natural gas revenue will increase by approximately $7.8 million (14.2%). Avista estimates that the average residential customer using 70 therms per month would see their monthly bill increase by approximately $8.21 (14.2%). Larger commercial customers would experience an average increase between 15.9% and 17.2%, with the higher increase percentages due to lower base rates. Incorporating its proposed changes to Rate Schedule 150, Avista recommends the following annualized change in PGA rates per customer class:

Customer Class	Schedule	Proposed Average Increase $ /Therm	Estimated Average Increase % Change	Proposed Average Price $/Therm
General	101	$0.11730	14.23%	$0.89446
Large General	111	$0.11730	15.92%	$0.85418
Commercial	121	$0.11730	17.24%	$0.79758
Large General	112	$0.11730	17.51%	$0.78702
Interruptible	131	$0.10750	18.06%	$0.70268
Interruptible	132	$0.10750	19.19%	$0.66768
Transportation	146	none	none	$0.10574

STAFF COMMENTS

Staff has reviewed the Application, performed an audit of the gas purchases from August 2003 through July 2004, and examined additional information supplied by the Company and third parties.

Staff believes that failure to increase rates to reflect market prices that have been volatile over the past five years would send an inappropriate price signal to customers. It may also cause significant deferred gas costs to be recovered through increases next year. Even with the increase proposed by the Company, gas cost deferrals could still occur. If the Company were to file based on August 13, 2004 forward prices, the WACOG would be about 2.5 cents higher than the proposed WACOG. Therefore, Staff recommends approving the Company's WACOG as requested. Considering market volatility and the possibility for price softening, Staff recommends that the Company be directed to file for an out-of-period rate decrease if the projected WACOG decreases 5% or more from the requested level.

In analyzing Avista's proposal, Staff noted that during the prior PGA period, the Company followed its price stabilization practice of systematically fixing portions of gas costs using financial instruments. These hedges provided substantial price protection and provided Idaho customers a benefit of $43,252 for the period.

Staff also discussed the ramifications of a Northwest Pipeline metering error. During a review of gas purchased from suppliers and sold to customers, Avista determined that it sold more gas to customers in the Lewiston area than it had purchased. Upon further investigation, it was determined that one of the Northwest Pipeline (Northwest) meters in the Lewiston area was set at a fixed-flow rate during September 2002 through February 2004. As a result, the deliveries to Lewiston from Northwest were significantly under-recorded and Avista owed the difference to Northwest. Northwest's tariff states that the gas must be replaced, and Avista was faced with purchasing significant amounts of gas from the current high-priced market. Because the gas is currently more expensive than during the time of the incorrectly set meter and the meter error was Northwest's fault, the Company was able to negotiate a settlement with Northwest to return less gas than was undercounted. Staff attached an analysis of the settlement agreement as Confidential Attachment A and the confidential settlement agreement between Avista and Northwest that details the amounts in question as Confidential Attachment B to its comments.

Because the allocation of pipeline and gas costs between Washington and Idaho is based on pipeline meter readings, the costs recorded during the meter error time period were incorrectly allocated. Staff has reviewed Avista's reallocation of costs between Idaho and Washington and believes it accurately represents actual conditions. Because the error occurred in Idaho, Idaho customers will be required to pay the majority of the costs associated with the meter error. The Company has appropriately reallocated some of the costs originally assigned to Washington back to the Idaho deferral account. The approximately \$3.5 million will be paid back through a \$2.4 million increase in the Idaho deferral account and a \$1.1 million increase in future gas costs.

In sum, Staff recommends that the Commission: 1) approve the Company's request to leave Schedule 155 at \$.03093 per therm to recover the deferred balance in approximately 18 months, 2) approve the Company-requested WACOG of \$0.55739 per therm, and 3) require the Company to file for an out-of-period rate decrease if the projected WACOG decreases 5% or more.

PUBLIC COMMENTS

As of August 26, 2004, the Commission had received six comments from customers regarding the proposed 14.2% purchased gas cost adjustment. All opposed the increase. Comments from the fixed-income customers stated it would be nearly impossible to pay higher rates for natural gas. As one customer stated, "I implore the Utilities Commission to reduce, if not deny outright, Avista's most recent request for rate increases." Several commenters cited the history of sizable rate increases over the past several years and insisted that the previously-approved rate increases should be sufficient for Avista's needs.

COMMISSION DECISION

Does the Commission wish to approve Avista Utilities' PGA Application as filed?

Lisa Nordstrom

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