RECEIVED ☒
FILED ☐
2005 OCT 20 PM 2:02
IDAHO PUBLIC
UTILITIES COMMISSION

DONOVAN E. WALKER
DEPUTY ATTORNEY GENERAL
IDAHO PUBLIC UTILITIES COMMISSION
PO BOX 83720
BOISE, IDAHO 83720-0074
(208) 334-0357
IDAHO BAR NO. 5921

Street Address for Express Mail:
472 W. WASHINGTON
BOISE, ID 83702-5983

Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA UTILITIES FOR AN ORDER APPROVING A CHANGE IN NATURAL GAS RATES AND CHARGES (2005 PURCHASED GAS COST ADJUSTMENT).	**CASE NO. AVU-G-05-2** **COMMENTS OF THE COMMISSION STAFF**

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Donovan E. Walker, Deputy Attorney General, respectfully submits the following comments in response to Order No. 29876, issued on September 29, 2005.

BACKGROUND

On September 12, 2005, Avista Utilities (Avista; Company) filed its annual Purchased Gas Cost Adjustment (PGA) Application with the Idaho Public Utilities Commission (Commission) requesting authority to place new rate schedules in effect as of November 1, 2005 that will increase its annual revenues by $15.7 million (23.8%). The PGA mechanism is used to adjust rates to reflect changes in the costs for the purchase of gas from wholesale suppliers including transportation, storage, and other related costs of acquiring natural gas.

The Company contends that its earnings will not be increased as a result of the proposed changes in prices and revenues.

THE APPLICATION

According to Avista's Application, if the requested price increase is approved the Company's annual revenue will increase by approximately $15.7 million or about 23.8%. The average residential customer using 70 therms per month would see an estimated increase of $16.36 per month.

Avista states that it purchases natural gas for customer usage and transports this gas over various pipelines for delivery to customers. The Company defers the impact of timing differences due to implementation of rate changes and differences between the Company's actual Weighted Average Cost of Gas (WACOG) purchased and the WACOG embedded in rates. Avista also defers the revenue received from the release of its Cascade storage capacity as well as various pipeline refunds or charges and miscellaneous revenue received from gas related transactions.

The Company requests an increase in the prospective natural gas cost component included in the rates charged to customers of 21.443 cents per therm. This consists of an increase of 21.047 cents per therm related to the commodity cost of purchasing and transporting gas for customer usage and an increase of 0.396 cents per therm related to fixed pipeline costs.

Avista requests an increase in the present WACOG from 55.739 cents per therm to 76.786 cents per therm, an increase of 21.047 cents. This reflects first-of-the-month (FOM) forward gas prices as of August 4, 2005, and the Company's hedges executed to date. The Company executes hedges to fix the price of gas on approximately 50% of its estimated annual gas sales for the year, and uses a dollar-cost averaging approach for executing hedges. The Company states that it has completed approximately 80% of its scheduled hedges for the upcoming PGA year, November through October.

The Company is also proposing a change in the present amortization rate, which 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. Avista proposes to increase the amortization rate from the present surcharge of 3.093 cents per therm to 5.027 cents per therm. The Company states it has a deferred gas cost balance of approximately $3.5 million as of June 30, 2005, reflecting higher gas costs than projected during the past year. The proposed increase in the amortization rate is expected to recover this balance over 12 months.

The Company states that notice of its proposed increase in price has been accomplished by posting a notice at each of the Company's district offices in Idaho, a press release distributed to various informational agencies, and a separate notice to each of its Idaho gas customers included in their billing. Avista attached copies of these notices to its Application.

The rates proposed by the Company, based on base rates currently in place, are shown below:

Customer Class	Schedule	Proposed Increase $/Therm	Estimated Average Increase % Change	Proposed Average Price $/Therm
General	101	0.23377	24.53%	1.18692
Large General	111	0.23377	26.57%	1.16890*
Large General	112	0.21443	23.91%	1.11863*
Commercial	121	0.23377	28.91%	1.15779*
Commercial	122	0.21443	26.88%	1.10752*
Interruptible	131	0.20414	28.69%	0.91560
Interruptible	132	0.21047	31.11%	0.88693
Transportation	146	0.00000	0.00%	0.10976

*Price per therm for initial block of usage

SCHEDULE 150 – PURCHASED GAS COST ADJUSTMENT

The purchased gas cost adjustment is a forward-looking cost adjustment that reflects the anticipated changes in the variable cost to purchase and transport natural gas for customers. Avista requests a Schedule 150 rate increase of $0.21443/therm for rate Schedules 101, 111, 112, 121 and 122, and a rate increase of $0.21047/therm for interruptible sales Schedules 131 and 132. The rate is based on an increase in the overall Weighted Average Cost of Gas (WACOG) proposed by Avista.

Weighted Average Cost of Gas

Avista has requested a WACOG of $0.76786/therm for the coming PGA year. This is an increase of 37.76 % over the present WACOG, which was approved in Order No. 29590 and became effective on September 9, 2004. The table below shows the past and the proposed WACOG along with the resulting total Schedule 101 (residential) tariff and the percent change in both the WACOG and the tariff for the most recent 5 years.

YEAR TARIIF WAS ESTABLISHED	APPROVED WEIGHTED AVG. COST OF GAS, $/THERM	% CHANGE FROM PREVIOUS YEAR		RESULTING TOTAL GENERAL SERVICE SCHEDULE 101 TARIFF, $/THERM	% CHANGE FROM PREVIOUS YEAR
2000	0.29500	Base Year		0.62036	Base Year
2001	0.48044	62.86%		0.89753	44.68 %
2002	0.34572	-28.04%		0.75722	-15.63%
2003	0.44989	30.13%		0.77716	2.63%
2004	0.55739	23.89%		0.95315	22.64%
2005 (proposed)	0.76786	37.76%		1.18692	24.53%

Last year's WACOG of $0.55739/therm was based on forward gas prices for the Company's supply sources as of the date of submittal, and while actual gas prices varied throughout the year, the WACOG was fairly reflective of the market rate until late summer of this year. However, in the past three months, the market indexes for natural gas have been extremely volatile and prices have increased significantly. In August and September the effects on natural gas production of two major hurricanes in the Gulf of Mexico contributed to the volatility. The NYMX price for natural gas peaked recently at $1.48 per therm and is currently in the $1.38 range. These weather factors have exasperated what was already a volatile market with increasing prices.

These increases in the Company's cost of purchasing natural gas and the price risk that natural gas market volatility poses to consumers in Idaho are driven by factors that have been previously recognized and evaluated by the Commission and Staff. Growing demand combined with long lead times to deliver new production to consumers contributes to the continuing upward price trends. In addition, construction in the past ten years of pipelines that can now deliver natural gas from the Company's natural gas sources to the Eastern United States and California markets in larger volumes than a few years ago contributes to the upward price trends. This increased market access for gas producers creates for the Company the same volatility and price increases as those experienced by other national and world market supplies.

The Company acquires the natural gas it sells to its customers by purchasing approximately 50 percent of forecast needs in advance of that need on a fixed price basis using a programmatic system aimed at providing low and stable prices relative to the market. The other

50 percent of the gas is acquired as spot or index priced gas in the market as needed. The programmatic purchasing is disciplined and is the result of specific company strategic review of markets and the setting of purchasing goals and triggers for purchase of gas based on needed volumes, windows of opportunity to purchase, and maximum and minimum purchase price goals. Fixed price gas volumes for the heating season are purchased months in advance.

Nationally, the levels of gas being placed into storage, for winter withdrawal, have dropped as the prices have risen in late summer and fall. However, the total national storage that will be available as the heating season begins is within the average range for the most recent five-year period. The Company relies on storage for winter demand peaks and has the needed capacity of the storage it owns available for this coming winter. Storage quantities with hedged purchases should be sufficient to meet winter peak demand.

The Company proposed WACOG of $0.76786, a 37.76 % increase over the 2004 approved WACOG, was reviewed by Staff against other forecasts, including those published weekly by the US Energy Information Administration. Staff notes that this requested increase, reflecting the Company's belief that the cost of gas will continue to rise, is consistent with the forecasted northwest regional cost of natural gas.

SCHEDULE 155 – DEFERRED EXPENSES

Avista uses an amortization rate set forth under Schedule 155 to refund or surcharge customers the difference between actual gas costs and the projected costs allowed in the previous PGA filing. In this Application, the Company requests an increase in the Schedule 155 amortization rate of $0.01934 per therm over the current surcharge of $0.03093 per therm or $0.05027 to recover approximately $3.5 million that has accrued through June 30, 2005. The proposed surcharge will allow Avista to recover its deferred costs in approximately 12 months.

In previous PGA filings, Avista has voluntarily amortized the deferred balance over periods longer than one year to mitigate the effects of price increases on customers. Avista has been the only utility company in Idaho to amortize this deferred balance over periods exceeding one year. However, in this current filing, Avista proposes to use a 12-month amortization period because of uncertainty and volatility in the natural gas markets. Staff believes that the 12-month amortization period for deferred balances is appropriate for this case, and recommends accepting the proposed surcharge increase.

The deferred balance consists of the following:

Deferred Account Item	Amount Accrued Through June 2005
Beginning Deferred Costs Balance	$3,577,077
Wholesale Gas Costs Above the WACOG	4,410,333
Fixed Pipeline Charges	373,132
Cascade Natural Capacity Releases	(192,172)
Benchmark Deferrals	(1,572,567)
Off-System Capacity Release/Sales	(719,010)
Interest on Deferrals	30,128
Administrative & General Benefit Credit	(26,475)
Refunds to Industrial Customers/Transfer to Amortization Accounts	(3,577,050)
Under-Collections from Prior PGA Year	1,180,489
Total Deferred Amount Owed by Customers	**$3,483,885**

Staff has reviewed the Application, performed an audit of gas purchases and reviewed additional information supplied by the Company and third parties. In analyzing Avista's proposal, Staff believes there are several issues that need to be addressed: the cost of hedges purchased for price stability, the cessation of the Benchmark Mechanism for gas purchases, the return of gas to Northwest Pipeline due to a meter error, and the necessity for sufficient documentation of gas procurement policies and practices.

Northwest Pipeline Meter Error

During last year's PGA case, Staff commented on a Northwest Pipeline (Northwest) meter error in Lewiston, Idaho, which allowed Avista to sell more gas to customers than it had purchased. Northwest's tariff states that the gas had to be replaced. Rather than Avista having to purchase more expensive gas in the high-priced market to replace the excess gas received, the companies negotiated a settlement for monthly replacement of the gas. The final payment for gas replacement to correct the meter error will be made this month and the additional deferral balance caused by the reallocation of costs between Idaho and Washington due to the error will have been completely removed.

Hedges and Financial Instruments

During the prior PGA period, the Company followed its price stabilization practice of systematically fixing portions of gas costs using physical hedges and financial instruments. Avista hedges up to its estimated minimum daily demand each month with a combination of fixed price gas purchases and scheduled withdrawals from available storage. Typically, these hedges total approximately 50 percent of the Company's forecasted loads. To quantify the benefits of the Company's hedging practices for the previous PGA year, the hedged price was compared to the First of Month (FOM) index price and the difference was multiplied by the hedged volume. For the period from July 2004 through June 2005, the Company's hedging cost approximately an additional $743,227. However, because of the recent spike in natural gas prices, the hedges executed during the summer months of 2005 should provide an enormous benefit to customers in next year's PGA filing.

Gas Procurement and Risk Management Policies and Procedures

Since September of 1999, Avista Utilities has purchased gas from its affiliate Avista Energy at a price based on a formula that factors in the index price of gas at the three basins in which gas was available to Avista: Alberta (AECO), British Columbia (Sumas) and Rockies. This benchmark price was paid by Avista Utilities regardless of the actual costs incurred by Avista Energy to procure the gas. Avista preferred this approach claiming that ratepayers benefited from Avista Energy's market presence, purchasing power and ability to absorb counterparty credit and other risks. At the same time, the price paid for gas by Avista Utilities would closely follow the market. In prior PGA filings, Staff has accepted this benchmark approach as reasonable.

In February 2004, the Washington Utilities and Transportation Commission ordered Avista Utilities to discontinue its use of the Natural Gas Benchmark Mechanism, citing among other things, the inherent risk to ratepayers with affiliate transactions where common management is incentivised to benefit shareholders at the expense of ratepayers. The WUTC also expressed concerns about the inability to quantify any benefits to customers under the mechanism.

Rather than attempting to maintain the Benchmark Mechanism in Oregon and Idaho while eliminating the mechanism in Washington, Avista discontinued using the mechanism in all of its service territories. Because the system is so intertwined, it could impose an undue burden on Avista Utilities to continue purchasing gas from Avista Energy under the Benchmark Mechanism in Idaho while simultaneously undertaking the tasks of managing the procurement and delivery of gas solely within Avista Utilities for its Washington customers. A backcast analysis using the Benchmark Mechanism will be evaluated to determine if eliminating the Benchmark Mechanism has harmed customers. This analysis will also be used as an evaluation tool for prospective procurement and risk management programs. Management fees were paid and passed through to customers under the Benchmark Mechanism. Avista Utilities will now incur additional salaries and other costs for gas procurement. These costs will be fully examined for reasonableness in the next rate case.

Staff believes a risk management program is very important for Avista Utilities and its customers. Staff recognizes that a common approach to gas procurement throughout all of Avista Utilities' jurisdictions may provide efficiencies that could also benefit customers significantly. Without Avista Energy to make gas purchases under the benchmark mechanism agreement for Avista Utilities, Avista Utilities was forced to rapidly implement a new Natural Gas Supply, Procurement and Hedging Policy. At this time, especially with high gas prices and volatility, it is critical for Avista Utilities to expand and formalize its risk management practices. Staff will work with the Company to formalize an acceptable program. Staff has reviewed the initial drafts of the policy and believes the policy takes the first steps to provide for disciplined purchases and hedges without speculation or causing undue risk to customers. However, Staff found little written documentation illustrating that the Company was following its written policies. To avoid second-guessing the reasonableness and prudence of the Company's purchases, adequate documentation surrounding such purchases is required. Enhancing the minutes of the Strategic Oversight Group to include details and surrounding circumstances of large natural gas purchases is a simple improvement that can be implemented immediately without causing an undue burden on the Company.

CONSUMER ISSUES

Avista's Purchased Gas Cost Adjustment (PGA) Application contained the customer notice and a press release. Staff reviewed the press release and the notice and determined that they complied with the requirements of IDAPA 31.21.02.102. The press release was issued on September 12, 2005. The notice was mailed with customers' bills beginning September 13, 2005 and ending October 11, 2005. Customers had until October 20, 2005 to file comments with the Commission. As of October 18, 2005, 26 customers filed comments.

In general, customers' comments focused on continued increases in the cost of natural gas and other necessities without commensurate cost of living increases for those on fixed incomes. Many of those who commented voiced concerns that families who are unable to afford higher heating bills will be forced to go without medications or other necessities. Several references were made to the historical representation that natural gas was an abundant and cheap source of fuel and to utilities efforts to encourage customers to convert to natural gas for space and water heating.

On October 11, 2005 at 7:00 pm, Staff presented a workshop in Coeur d'Alene to discuss the proposed rate increase. Five community members were present. Their questions concerned how the proposed rate increase would affect citizens on fixed incomes. There was a request for information on weatherization programs and the amount of financial assistance contributed by Avista.

Avista Utilities shareholders give more to fuel funds on a per-customer basis than any of the other regulated utilities in Idaho. In the past 5 years, Avista shareholders have given a total of $565,000 to Project Share. In addition to the donations to fuel funds, an agreement was reached last year with the Community Action Partnerships of Idaho in which Avista agreed to increase its funding for low–income weatherization purposes from $108,000 per year to $350,000 per year.

STAFF RECOMMENDATION

Given that natural gas market prices have actually increased since the Company's filing in September, Staff recommends that the requested increase in the WACOG and the twelve-month amortization of deferred expenses be approved. Any reduction in the WACOG requested by the Company could expose customers to greater WACOG increases and larger deferred balances next year. Staff also recommends that the Company be directed to continue its monthly reporting of the changes to and balances in the deferral accounts, continue reporting the WACOG quarterly, and enhance it's documentation of gas hedging.

Respectfully submitted this 20th day of October 2005.

Donovan E. Walker
Deputy Attorney General

Technical Staff: Donn English
Tammie Estberg
Marilyn Parker
Harry Hall

i:umisc/comments/avug05.2dwdemptehh

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 20TH DAY OF OCTOBER 2005, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. AVU-G-05-2, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

DAVID J. MEYER
SR VP AND GENERAL COUNSEL
AVISTA CORPORATION
PO BOX 3727
SPOKANE WA 99220-3727
E-mail dmeyer@avistacorp.com

KELLY NORWOOD
VICE PRESIDENT – STATE & FED. REG.
AVISTA UTILITIES
PO BOX 3727
SPOKANE WA 99220-3727
E-mail Kelly.norwood@avistacorp.com

SECRETARY