DECISION MEMORANDUM

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

FROM: SCOTT WOODBURY

DATE: JULY 22, 2004

RE: CASE NO. AVU-G-03-2 (Avista)
2003 NATURAL GAS INTEGRATED RESOURCE PLAN (IRP)

On December 30, 2003, Avista Corporation, dba Avista Utilities (Avista; Company) filed its year 2003 natural gas Integrated Resource Plan (IRP) with the Idaho Public Utilities Commission (Commission). The Company's filing complies with the Commission's direction in Order No. 25342, Case No. GNR-G-93-2 (reference PURPA Section 303(b)(3), Energy Policy Act of 1992). Pursuant to the Commission's Order, the Company is required to file every two years.

Integrated Resource Planning, the Company states, is a comprehensive, long-range planning tool that fully integrates forecasted energy requirements with potential energy resources. The process determines the most cost-effective means for the Company to meet projected firm load requirements.

The Company's Integrated Resource Plan is presented in a combined format to provide the reader with an overall view of the Company's total natural gas operations and planning processes. In addition to Idaho, the Company's IRP is filed with the regulatory authorities in Washington and Oregon. Avista Utilities prepares its natural gas forecasts concurrently with its electric operations forecast where electricity and natural gas are both provided to customers, thus utilizing common assumptions for both energy products.

Avista's 2003 natural gas IRP addresses the following subject areas: natural gas sales forecast, demand side management, supply side resources, distribution planning, integrated resource portfolio, public involvement and action plan.

Avista's gas and electric energy efficiency activities in Idaho and Washington have been funded under a Tariff Rider mechanism since 1995. This allows for the funding of energy efficiency activities without creating a regulatory asset. The gas Tariff Rider is currently set at 0.5%. This funding mechanism yields approximately $1 million in annual revenues. The four year (2002-2005 inclusive) business plan calls for combined gas and electric DSM expenditures to be limited to approximately 62% of Tariff Rider revenues.

Electric and gas DSM programs are subdivided into three portfolios: non-residential, residential and limited income. Within the non-residential portfolio there is a heavy reliance upon site specific calculations of energy savings. Residential segment gas DSM is composed of prescriptive programs. Prescriptive residential gas efficiency programs for programmable thermostats, high-efficiency gas furnaces, high-efficiency gas water heating and weatherization (duct, floor, wall, ceiling and attic) are currently available. Qualified limited income customers are eligible for incentives implemented through five separate community action program (CAP) agencies within the Avista service territories.

The supply options of Avista's integrated resource portfolio consist of various components. These include firm and non-firm supplies contracted for on a long-term and short-term basis, firm and interruptible transportation on seven interstate pipelines, and three storage services. A diversity of delivery points and load requirements adds to the options available to meet customer needs. The utilization of these components varies depending on demand and operating conditions.

The Company notes that it entered into an agreement with Avista Energy in 1999 to have Avista Energy manage all the supply and transportation needs of Avista Utilities (except California). The pricing and sharing structures vary between the states. The current mechanism is approved in Oregon and Idaho until March 31, 2005 and until January 29, 2004, in Washington. At the time of its IRP filing, Avista was awaiting the WUTC Order to determine the future status of the "benchmarking" mechanism.

In 2000, the industry experienced the highest prices ever seen. In response, Avista Utilities, through Avista Energy, has established a schedule to lock-in hedges and volumes for price stability. The hedging schedule provides for both structure and flexibility for both timing and volumes. Avista has established a base line that approximately 50% of annual monthly loads will be hedged prior to entering into the heating season, that being November 15, with fixed priced natural gas.

The Company in its resource management activities also considers other potential resources. These potential resources include those requiring physical assets and those dependent upon contractual or financial arrangements, e.g., Jackson Prairie Storage Project; pipeline capacity; capacity release; additional storage facilities. The Company holds several long-term contracts for supplies from three separate supply basins. These supplies are for annual and seasonal core customer needs. The Company does not make long-term firm commitments to serve interruptible customers.

Avista contends that its firm and interruptible transportation contracts provide the Company with sufficient available capacity to meet current and future core load demands. Based on the current forecast, the Company's north operating division (Washington and Idaho) will need to acquire additional transportation by the 2007/2008 heating season. As reflected in its filing, the Company's strategy is to contract for a reasonable amount of transportation to serve firm customers should a designed peak day occur in a seven- to ten-year period. Too much firm transportation could keep the Company from achieving its goal of being a low-cost energy provider. The ability to release capacity, however, acts to offset the cost of holding under-utilized capacity. Too little firm transportation impairs the Company's goal of being a reliable energy provider.

Avista's analysis and selection of resource options in the context of the IRP for its natural gas operations as well as the resulting strategies employed to develop an Integrated Resource Plan are comprised of:

- Resource options summary
- Gas resource model
- Analysis framework
- Weather data
- Avoided cost
- Environmental externalities
- Portfolio integration

The foundation for the selection of resources for the Company's integrated resource portfolio is the annual and peak day load forecast requirements.

The objective of Avista's 2003 Action Plan is to continue to further integrate the objectives of integrated resource planning and least cost planning into the Company's daily operations. The 2003 Action Plan is focused on six key areas: sales forecasting; modeling/forecasting; supply/capacity; DSM; distribution planning and public involvement.

On June 4, 2004, the Commission issued a Notice of Filing in Case No. AVU-G-03-2 and established a June 25 comment deadline. Timely comments were filed by Commission Staff. Staff believes that Avista's 2003 Natural Gas IRP satisfies and complies with the technical requirements of

Commission Order No. 25342. Staff notes that Avista's 2003 Natural Gas IRP provides the Company's load growth and pricing forecast. It provides insight into the Company's use of integrated resources by analyzing supply alternatives, including spot, firm and interruptible markets. The IRP further includes the use of storage, futures, options, multiple pipeline purchases, and demand side management to provide an integrated look at the Company's natural gas resources. Staff recommends that the Company's filing be acknowledged and accepted. Staff provides additional comments on the Company's Schedule 163 Natural Gas Benchmark Mechanism.

Benchmark Mechanism

Staff notes that on February 13, 2004, the Washington Utilities and Transportation Commission (WUTC) in Docket No. UG-021584 found that Avista's Benchmark Mechanism proposal had not provided adequate safeguards in affiliate transactions between Avista and Avista Energy nor were there significant measurable benefits to ratepayers. The natural gas Benchmark Mechanism is a Schedule 163 tariff program where Avista Energy manages all of Avista Utilities natural gas marketing and storage facilities. The program establishes the cost of natural gas for the States of Washington, Idaho and Oregon. It prices natural gas at the first of the month price based on an artificial weighting of the three supply basins serving the Northwest regardless of actual purchase price or delivery location. The Benchmark Mechanism also includes storage management, a hedging program and sharing of capacity releases between Avista Energy and Avista Utilities for all three states.

The WUTC rejected Avista's proposed modifications to the natural gas Benchmark Mechanism and extended the current mechanism for 60 days for Avista to submit a transition plan. On April 2, 2004, the WUTC extended the expiration of the Benchmark Mechanism to April 30, 2004 and approved Avista's plan for transitioning from purchasing natural gas through Avista Energy and the Benchmark Program to the direct purchase of natural gas by Avista Utilities. The transition plan calls for Avista Utilities to contract with Avista Energy to purchase natural gas based on Avista Utilities purchase decisions until March 2005. Avista Utilities proposes to acquire and train additional personnel and return to internally purchasing natural gas for all of its natural gas customers in Oregon and Idaho effective April 1, 2005.

Staff notes that Avista's 2003 IRP only briefly mentions the then pending actions of the Washington Commission in Appendix G, under evaluation of the previous plan, supply/capacity. Staff believes that the WUTC's rejection of the Benchmark Mechanism is a significant event that should be addressed greater a supplemental filing associated with the IRP. Staff admits that the change should not affect the overall demand for natural gas. However, the change will affect the way the Company buys natural gas. Changes will also occur in personnel costs as well as in transportation and storage planning. Furthermore, the overall strategy for hedge purchasing and storage management is subject to change, because it is an integral part of the current Benchmark Mechanism.

Staff believes that Idaho customers have benefited from some of the Benchmark components. Staff is concerned that with the loss of the Benchmark Mechanism, beneficial programs may be lost and additional costs may be shifted to Idaho. Staff recommends that the Company be directed to provide Staff copies of all Benchmark transition documents submitted in other states.

Pursuant to Commission Order in Case No. AVU-G-01-3, the Company is to file an analysis of the Benchmark program detailing the costs and benefits to customers, to the Company and to Avista Energy seven (7) months (i.e., on or before August 31, 2004) prior to the contract's termination on March 31, 2005. Order No. 28941 at 7. Staff will review the required filing and continue to monitor the Company's transition actions closely.

COMMISSION DECISION:

Staff recommends that Avista's Natural Gas Integrated Resource Plan filing be acknowledged and accepted. Staff recommends that the acknowledgement not be interpreted as approval, or as a judgment of prudence of the IRP or the prudence of following or not following the plan. Staff notes that elimination of the Benchmark Mechanism has the potential for significant ramifications in Idaho. Staff recommends that Avista be directed to provide Staff copies of all Benchmark transition documents submitted in the Company's other jurisdictional states. Does the Commission wish to acknowledge the Company's 2003 Natural Gas IRP and direct the Company to provide Staff with Benchmark transition documents? Does the Commission wish to direct the Company to make a supplemental IRP filing addressing the Benchmark Mechanism, regulatory changes and related ramifications? If not, how does the Commission wish to proceed?

Scott D. Woodbury

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