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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 (2006 PURCHASED GAS COST ADJUSTMENT)

CASE NO. AVU-G-06-3

COMMENTS OF THE COMMISSION STAFF

The Staff of the Idaho Public Utilities Commission, by and through it Attorney of Record, Donovan E. Walker, Deputy Attorney General, in response to the Notice of Application and Notice of Modified Procedure, issued on October 4, 2006, Order No. 30141, submits the following comments.

BACKGROUND

On September 14, 2006, Avista Utilities filed its annual Purchased Gas Cost Adjustment (PGA) Application with the Commission requesting authority to place new rate schedules in effect as of November 1, 2006 that would increase its annual natural gas revenues by approximately $2.7 million (3.2%). 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. Avista's earnings would not be increased as a result of the proposed changes in prices and revenues.

On September 29, 2006, Avista filed a revised PGA Application and tariff sheets with the Commission to adjust the Company's proposed weighted average cost of gas (WACOG) to reflect a further reduction in wholesale natural gas prices. The revised Application proposes to reduce the Company's estimated annual natural gas revenues by approximately $2.8 million (3.4%).

The Revised Application

According to Avista's Application if the requested price decrease is approved the Company's annual revenue will decrease by approximately $2.8 million or about 3.4%. The average residential or small commercial customer using 65 therms per month would see an estimated decrease of $2.70 per month (3.4%).

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 effect of timing differences due to implementation of rate changes and differences between the Company's actual WACOG purchased and the WACOG embedded in rates. Avista also defers the revenue received from the release of its storage capacity as well as various pipeline refunds or charges and miscellaneous revenue received from gas related transactions.

Avista's original Application requested an increase in the WACOG from its present 78.600 cents per therm to 84.712 cents per therm. The revised Application requests a decrease in the WACOG from its present 78.600 cents per therm to 76.244 cents per therm. The proposed WACOG is based on a weighting of forward natural gas prices on September 21, 2006, for unhedged volumes, and the Company's hedges executed to date. The Company generally executes hedges to fix the price of gas on approximately 66% of its estimated annual gas sales for the year, and uses a dollar-cost averaging approach for volumes to be hedged, with those volumes divided into 45-day execution windows between February 15 and November 15. The Company states that it has hedged approximately 60% of its estimated annual gas sales for the forthcoming year. It states it will hedge an additional 20% of the estimated sales within days of the revised Application filing, in order to take advantage of the recent sharp drop in forward gas prices.

This past year the Company has begun incorporating an amount of longer-term hedges into its purchase portfolio to provide an additional degree of rate stability. Approximately 11% of the total purchases for the next year have been hedged at a three-year fixed price. The Company's plan is to keep layering-in three-year fixed price hedges until these hedges represent one-third of the portfolio going forward. This plan has been incorporated into the Company's Risk Management Policy and has been provided to Commission Staff.

The Company's proposed rates in this filing also incorporate the proposed rate increases filed by the Company's two main pipeline suppliers, Northwest Pipeline and Gas Transmission Northwest. The proposed pipeline rates, while not yet approved, are set to begin being billed to Avista on January 1, 2007. The Company states that while these pipeline rate increases are substantial, the effect on the Company's proposed rates in this filing is completely mitigated by an increase in the estimated revenue to be received from pipeline capacity releases.

The Company is also proposing a change in the present amortization rate, which is used to refund or surcharge to customers the difference between actual gas costs and projected gas costs from the last PGA filing over the past year. Avista proposes to decrease the amortization rate from the present surcharge of 5.027 cents per therm to 3.420 cents per therm. The Company states it has an estimated deferred gas cost balance of approximately $2.8 million as of October 31, 2006, reflecting higher gas costs than projected during the past year. The proposed amortization rate of 3.420 cents per therm is expected to recover this balance over 12 months.

The Company states that notice of its Application 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 rates currently in place, are shown below:

Customer Class	**Schedule**	**Proposed Decrease $/Therm**	**Estimated Average Decrease % Change**	**Proposed Average Price $/Therm**
General	101	-0.04154	-3.36%	1.14538
Large General	111	-0.04154	-3.74%	1.12736*
Large General	112	-0.02547	-2.28%	1.09316*
Commercial	121	-0.04154	-3.98%	1.11625*
Commercial	122	-0.02547	-2.57%	1.08205*
Interruptible	131	-0.00148	0.16%	0.91412
Interruptible	132	-0.00701	-0.79%	0.87992
Transportation	146	0.00000	0.00%	0.10976

* Price per therm for the initial block of usage

STAFF ANALYSIS AND REVIEW

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 decrease of 2.547 cents per therm for firm sales customers on rate Schedules 101, 111, 112, 121 and 122. Interruptible customers on Schedules 131 and 132 will see a rate decrease of .701 cents per therm. These rates are based on the decrease in the overall Weighted Average Cost of Gas (WACOG) proposed by Avista.

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 is proposing to decrease the present Schedule 155 amortization rate by 1.607 cents per therm from the current surcharge of 5.027 cents per therm. The proposed surcharge of 3.420 cents per therm will allow the Company to recover its deferred costs of nearly $2.8 million in approximately twelve months. The deferred balance consists of the following:

Deferred Account Item	**Amount Accrued Through October 2006**
Beginning Deferred Costs Balance	$3,483,885
Wholesale Gas Costs Above WACOG	5,103,051
Fixed Pipeline Charges	554,265
Cascade Natural Capacity Release	(233,446)
Off-System Capacity Release/Sales	(2,367,776)
Interest on Deferrals	187,259
Refunds to Industrial Customers/Transfer to Amortization Accounts	(16,428)
Over-Collections from Prior PGA Year	(3,935,178)
Total Deferred Amount Owed by Customers	**$2,775,633**

Staff has reviewed the Application, performed an audit of gas purchases and hedging, and reviewed additional information provided by the Company and third parties. In analyzing Avista's proposal, Staff notes a few issues that need to be discussed further: pipeline transportation rate cases pending before the Federal Energy Regulatory Commission (FERC), a backcast analysis of the cessation of the Benchmark Mechanism for gas purchases, and the Company's hedging policies.

Effects of the 2005 Hurricane Season

After the Company made its filing in last year's PGA case, Case No. AVU-G-05-2, and before the Commission ultimately issued its final Order in that case, Hurricanes Rita and Katrina struck the gas and oil producing areas of the Gulf of Mexico and the Gulf Coast. The disruption of gas supply in the Gulf of Mexico caused very large spikes in the wholesale cost of natural gas throughout North America. This increase in the prices of natural gas after the hurricanes was not anticipated in the WACOG approved by the Commission and resulted in the Company having to purchase natural gas at prices much higher than had been forecast. This results in a larger amount that must be included in this year's cost adjustment for recovery of deferred costs resulting from the several months of high prices following the two hurricanes. This is lower than last year, but would have been lower still if it not for the storms' affect.

Pipeline Transportation Rate Cases Pending Before FERC

On June 30, 2006 Northwest Pipeline Corporation (NPC) and Gas Transmission Northwest (GTN), two of the interstate systems on which Avista transports gas, filed general system rate cases with the FERC. The FERC suspended the effective dates of the rate increases until January 1, 2007, subject to refunds to be determined by the conditions and outcome of hearings to be held at a later date. Staff has been working with intervenors in these proceedings and will continue to do so to ensure that the interests of customers are represented.

In its Application, Avista's proposed prices are weighted to account for the January 1, 2007 effective date of the proposed price increases. Though the outcome of the proceedings are still uncertain until final orders are issued by FERC, an increase in transportation costs is likely given that rates charged by these two pipeline corporations were established over ten years ago. However, the sizes of the proposed increases are large and there is a significant difference between the NPC and the GTN increases, in both the amount and the reasons for the increases. NPC has requested an increase of approximately 42% over the current tariff due primarily to operational and maintenance issues. GTN has requested an increase of over 70% due primarily to decreased demand resulting from competing pipelines with lower tariffs. Since both increases are subject to possible negotiations between the pipelines and their customers (including Avista) and are subject to FERC approval, it is reasonable to expect that the approved transportation price increases may be lower than those requested by the pipelines.

The weighting methodology used by the Company to determine the annual impact of the January 1, 2007 pipeline rate increases on the total cost of service is appropriate. The methodology aligns the transportation increases with the Purchased Gas Cost Adjustment during the PGA year in which the increases will occur. The methodology will also promote price stability to customers by limiting the amount that would have been deferred until the 2007 PGA filing. Rather than the Company deferring until next year the entire effect of the increase, the Company will only have to true-up any differences between the Applications filed by GTN and NPC and the final order issued by FERC. With Avista's proposed price decrease and uncertainties in the natural gas market, Staff believes that measures to defray future deferrals will serve the best interest of the ratepayers.

Staff recommends that, in the event that the FERC approved rate increases are significantly lower than those requested by the pipeline companies, or the forecasted WACOG decreases materially from what Avista has proposed in its Application, the Company file to further reduce tariffs approved in this proceeding.

Weighted Average Cost of Gas

Avista has requested a WACOG of $0.76244/therm for the coming PGA year. This is a decrease of $0.00542/therm or approximately 0.71 percent from the present WACOG which was approved in Order No. 29902 and became effective November 1, 2005. The table below shows the past and the proposed WACOG along with the resulting effect on residential customers (Schedule 101) and the percentage change in both the WACOG and the Schedule 101 tariff for the most recent five years.

YEAR TARIFF 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
2001	0.48044	Base Year		0.89753	Base Year
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	0.76786	37.76%		1.18692	24.53%
2006 (Proposed)	0.76244	-0.71%		1.14538	-3.50%

Last year's WACOG of $0.76786/therm was based on forward gas prices as of August 4, 2005, and while gas prices varied throughout the year, the WACOG was fairly reflective of the market rate.

The Company's proposed WACOG of $0.76244/therm was reviewed by Staff against other forecasts, including those published weekly by the US Energy Information Administration. Staff notes that this requested decrease, reflecting the Company's belief that the cost of gas will decrease slightly, is consistent with the forecasted northwest cost of natural gas. Use of this forward pricing may be regarded as aggressive and has the potential, if prices are higher to result in a large deferral balance to be recovered in the rates to be set a year from now for the 2007-2008 gas-year. However, as discussed below, the Company is currently actively participating in the natural gas markets to purchase price hedges for the approximately 20% of the 2006-2007 gas-year supply that it has not already purchased. As discussed below, this action will further reduce the price risk faced by customers.

Hedging Policies

Avista continues to follow its price stabilization practice of systematically fixing portions of gas costs using physical hedges and financial instruments in a time staggered purchasing procedure aimed at achieving a diversified portfolio of purchases and hedges. 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 66 percent of the Company's forecasted loads, although for the forthcoming PGA year, the hedges total nearly 80 percent of the forecasted load. Recent sharp drops in forward prices, and the volatility of the wholesale natural gas market led to the additional hedged amounts. If prices continue to drop, Avista plans to execute additional hedges beyond the 80 percent of forecasted demand.

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 1, 2005 through September 30, 2006, the Company's hedging practices, including storage withdrawals, provided a benefit to customers of approximately $2,766,874.

During the past eight months, when purchasing gas for the coming gas-year, the Company has pursued the revised natural gas procurement program that it proposed approximately one year ago. Under that program, 11% of supply is now purchased, at a fixed price, three years in advance. Next year another 11% will be added and the same the following year. Each year the Company will purchase 11% to replace the 11% contract(s) that expire. The resulting 33% purchased with three-year terms will result in more price stability than has been the case in recent years. Commission Staff continues to work with the Company to evaluate this methodology and to develop other hedging and purchasing practices with the intent of both stabilizing and reducing gas costs.

Cessation of the Benchmark Mechanism

Prior to 2004, Avista Utilities purchased gas from Avista Energy at a fixed price based on a formula that factors in the index price of gas at the three basins from 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. 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 holding company management receives incentives for acting to benefit shareholders at the expense of ratepayers.

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. Staff addressed the issue in its comments in the 2005 PGA case, Case No. AVU-G-05-2. Staff's concern was that actions prompted by the Washington UTC may harm customers in Avista's Idaho service territory. Subsequent to the Commissions Order in that case (Order No. 29902) Staff worked with the Company to complete a backcast analysis to determine if Idaho ratepayers would be harmed by the cessation of the mechanism. Based on the analysis assumptions, Staff believes it is reasonable to conclude that Idaho customers benefited slightly from the cessation of the mechanism by approximately $25,000.

CONSUMER ISSUES

Avista's Purchased Gas Cost Adjustment (PGA) Application received on September 13, 2006 contained the customer notice and a press release. Staff reviewed the press release and the notice and determined that the Company was in compliance with the requirements of IDAPA 31.21.02.102. The press release was issued on September 14, 2006. The customer notice was mailed with customers' bills beginning September 15, 2006 and ending October 13, 2006.

On September 29, 2006 Avista filed a revised request that would result in a net decrease to its natural gas customers. The Company filed a revised Application because natural gas prices fell dramatically in September. Customers had until October 24, 2006 to file comments with the Commission. As of October 19, 2006, six customers had filed comments. All the comments addressed the September 13 Application where Avista had requested an increase in rates.

Customer Comments

Five of the six customers that commented on the case were concerned about any increases in natural gas rates because newspaper articles and other media have reported that market prices for natural gas are at two-year lows.

One customer referred to a Fox news report that stated, "Industry officials said homeowners that depend on natural gas for heat should see lower bills this winter, assuming normal temperatures." The customer wanted to make certain that the IPUC was aware of this report.

Financial Assistance For Paying Heating Bills

Although Avista's rates for residential customers will drop slightly if the Commission approves its request, many customers will still struggle to make ends meet. Staff encourages those customers who qualify for energy assistance to apply for the federally-funded Low Income Home Energy Assistance Program (LIHEAP) and other non-profit fuel funds such as Project Share. For more information regarding assistance programs, customers may call the local Community Action Agency, Avista Utilities, the Idaho Public Utilities Commission, or, for other community resources, the 2-1-1 Idaho Care Line.

RECOMMENDATION

After a complete examination of the Company's Application and gas purchases for the year, Staff recommends the following:

1. That the Commission accepts the Company's Revised Application and filed tariffs reducing the Company's annual revenue by approximately $2.8 million.
2. The Company should be directed to file for further tariff decreases if the forecasted WACOG decreases materially or if the result of the pipeline cases pending before the FERC results in transportation expenses significantly less than what Avista has included in its proposed tariffs.

Respectfully submitted this 24th day of October 2006.

Donovan E. Walker
Deputy Attorney General

Technical Staff: Harry Hall
Donn English
Marilyn Parker

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 24TH DAY OF OCTOBER 2006, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. AVU-G-06-03, BY E-MAILING A COPY THEREOF AND BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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