DECISION MEMORANDUM

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

FROM: CECELIA A. GASSNER

DATE: APRIL 11, 2007

SUBJECT: AVISTA CORPORATION'S APPLICATION REQUESTING APPROVAL OF A NATURAL GAS TRANSPORTATION SERVICE AGREEMENT, CASE NO. AVU-G-07-01

On February 20, 2007, Avista Corporation ("Avista" or "Company") filed an Application with the Commission requesting approval of a Natural Gas Transportation Service Agreement (the "Agreement") between the Company and Potlatch Forest Products Corporation ("Potlatch"). This Commission has the jurisdiction over such request pursuant to *Idaho Code* §§ 61-307, 61-622 and 61-623. The Company requested that the Application be processed by Modified Procedure.

On March 13, 2007, the Commission issued a Notice of Application and Modified Procedure and solicited comments from interested parties. Order No. 30271. The only comments submitted were filed by Staff.

THE APPLICATION

According to the Application, Avista has been providing natural gas transportation service to Potlatch's Lewiston, Idaho plant under an existing agreement since 1993. During that time, Potlatch has increased its efficiency and reduced its annual natural gas consumption from 64 million therms to 38 million therms. Application at 2. In addition, Avista has seen considerable load growth in the Moscow/Lewiston area and an increased need for pipeline capacity. *Id.* Avista and Potlatch negotiated a capacity release agreement, and Potlatch expressed its desire to negotiate a new gas distribution agreement as well. *Id.* at 3.

The initial term of the Agreement is ten years, beginning the day following Commission approval and ending November 30, 2016. The parties have agreed on charges based upon Potlatch's desire to pay Avista for distribution service in the future that more reasonably reflects the alternative cost of connecting directly to a different pipeline, and Avista's desire to retain a reasonable level of distribution charges. *Id.* at 3-4. Based on Potlatch's usage in 2006, its annual bill under the existing agreement is $264,000. *Id.* at 4. Under the Agreement, Potlatch would pay: $185,000 through November 2007; $150,000 from December 2007 through November 2008; $111,000 from December 2008 through November 2009; and $74,000 per annum from December 2009 through the end of the Agreement. *Id.* The Company believes that the current and projected rate of growth it is experiencing in north Idaho should offset a portion of the lost revenue/margin received from Potlatch under the existing agreement. *Id.* at 4-5.

STAFF COMMENTS

Staff has reviewed the Application and the proposed contract with Potlatch. Several issues were considered in order to determine whether, if approved, this contract will have consequences beyond the services provided to Potlatch. The Company's costs to serve as well as the existing contract were also reviewed.

The ability of Potlatch to secure a by-pass of the Company and be served directly from the interstate pipeline via third party contracts is an important issue influencing both the Company's negotiation of terms in the proposed contract and Staff's review of that contract. Potlatch, as a large user of natural gas, has the right to contract for supply of natural gas independent of the Company and to contract with Northwest Pipelines (NWPL) to deliver that gas to a nearby point. Because the pipeline is close to the Potlatch facility and there is an existing tap into the pipeline that could be used to supply Potlatch, a by-pass could be inexpensive and quickly completed. Of particular note is that the Company has imbedded (fixed) costs associated with serving Potlatch that will not go away, even if Potlatch is no longer a customer.

Staff's review of the financial contract terms was aimed at answering two questions – (1) does the revenue from the proposed contract pay for the variable costs of providing the service to Potlatch; and (2) if it does, what part of the Company's fixed costs allocated to that service is covered by the revenue margin over and above the variable costs of that service? The costs to Potlatch are a single Annual Delivery Charge that is paid monthly.

Fixed costs associated with this service are all associated with the capital investment in the regulator station, short run of piping (100 feet) and odorizer used to serve Potlatch. This equipment is highly depreciated and has a low residual book value and therefore very low annual fixed costs. It is Staff's opinion that, given the negotiating position, the Company has negotiated an acceptable net contribution to fixed costs.

Staff believes this contract is in the best interest of both the Company and its customers. Staff recommends that the Commission approve the contract as proposed.

COMMISSION DECISION

Does the Commission desire to approve the Application?

Cecelia A. Gassner

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