DECISION MEMORANDUM

TO: COMMISSIONER SMITH
COMMISSIONER REDFORD
COMMISSIONER KEMPTON
COMMISSION SECRETARY
COMMISSION STAFF

FROM: DONOVAN E. WALKER

DATE: OCTOBER 25, 2007

SUBJECT: AVISTA'S 2007 PURCHASED GAS COST ADJUSTMENT (PGA) – CASE NO. AVU-G-07-02.

On September 17, 2007, Avista 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, 2007, that would decrease its annual natural gas revenues by approximately $4 million (4.6%). 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 will not be increased as a result of the proposed changes in prices and revenues.

On September 27, 2007, the Commission issued a Notice of Application and Notice of Modified Procedure to process the Application. Commission Staff was the only party to file comments, and recommended approval of the Company's Application.

THE APPLICATION

Avista states if the changes proposed in its Application are approved its annual revenue will decrease by approximately $4 million or 4.6%. The average residential or small commercial customer using 65 therms per month would see an estimated decrease of $3.65 per month (4.6%).

The Company 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 weighted average cost of gas (WACOG) purchased and the WACOG embedded in rates. The Company states that it 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 requests a decrease in the WACOG from its present $0.76085 cents-per-therm to $0.75544 cents-per-therm, a decrease of approximately $0.005 per therm. The Company states that approximately 70% of its estimated annual load requirements for the PGA year will be hedged at a fixed price comprised of: (1) approximately 41% of volumes hedged for a term of one year or less; (2) approximately 18% hedged for a three-year term; and (3) 11% of volumes in Jackson Prairie storage. This planned level of hedging is similar to the prior year. During 2006, the Company began incorporating three-year fixed price hedges into its portfolio to provide additional rate stability. Through the end of August, approximately 2/3 of planned hedge volumes for the PGA year have been executed at a weighted average price of $7.94 per decatherm ($0.794 per therm).

The demand cost included in the Company's Application primarily represents the cost of pipeline transportation to the Company's system. Overall, total demand costs reflected in this PGA filing were essentially flat, as compared to the total costs reflected in the 2006 PGA filing. However, projected firm sales volumes are substantially lower in this filing as compared to the projected volumes in the 2006 filing. Therefore, a similar level of dollars is recovered over a lower level of volumes, thus resulting in a proposed increase per therm. The Company's proposed rates in this filing include a decrease that reflects the settlement of the Northwest Pipeline's (NWP) FERC rate case. However, this decrease is offset by the inclusion of higher rates for Gas Transmission Northwest (GTN), whose FERC rate case is still pending, as well as increases in Canadian pipeline charges. Additionally, during 2007 the Company terminated its agreement related to the Plymouth LNG peaking facility, resulting in a savings of $124,000 per year in fixed demand costs.

The Company is also proposing a change in the present amortization rate that 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 present amortization rate for firm-sales customers is approximately a 3.4 cents-per-therm surcharge. The proposed decrease in the amortization rate results in a refund rate of approximately 2.4 cents-per-therm to pass back estimated over-collected gas costs of approximately $1.7 million as of November 1, 2007.

STAFF COMMENTS

Staff reviewed the Company's Application; performed an audit of gas purchases, hedging and risk management policies, and deferred expense accounts; and reviewed additional information provided by the Company and third parties. Staff verified that the Company's earnings would not change as a result of the proposed changes in the Application. Staff's comments include discussion of the Company's hedging policies, the proposed change in the WACOG, the Company's deferred expense account, customer issues, and the Federal Energy Regulatory Commission (FERC) pipeline rate cases.

Staff recommended that the Commission approve the Company's Application and filed tariffs, reducing the Company's Schedule 155 tariff (deferral balance amortization) to a 2.391 cents-per-therm credit, and accepting the Company's proposed WACOG of 75.544 cents per therm. This would reduce the Company's annual revenue by approximately $4 million. Staff also recommended that should rates be approved by FERC in the GTN rate case that are lower than those included in this case by Avista, that any and all refunds be credited back to Avista's customers.

Staff commented that the Schedule 155 deferred cost amortization is proposed to decrease from the present surcharge of 3.42 cents-per-therm to a credit of 2.391 cents-per-therm. This would provide for a refund to customers over the next 12 months of approximately $1.7 million in over-recovery of deferred costs from the previous year.

The Company's Application proposed to pass back to customers the benefits from the settlement of the Northwest Pipeline Corporation (NPC) general rate case. On March 30, 2007, FERC issued an order approving the settlement effective April 1, 2007. Avista had previously included recovery of NPC's filed rates, and now proposes to reduce that amount to the rates approved in the settlement. This would result in approximately $430,000 passed back to customers. Additionally, Avista proposed to incorporate the annualization, or 12-month application, of GTN's filed rates in its pending rate increase before FERC. This would increase Avista's annual revenue by approximately $140,000. Staff commented that this treatment is consistent with the treatment of NPC's and GTN's rate case filing in the previous year's PGA, and reasonable given the uncertainty of the timing and amount of increase to be granted by FERC. Staff also recommended that should FERC approve an increase less that that proposed by GTN, that any and all refunds should be credited back to Avista's customers.

Staff reviewed the Company's proposed WACOG of 75.544 cents-per-therm against other forecasts, including those published weekly by the U.S. Energy Information Administration. Staff noted 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. Although Avista's proposed decrease in the WACOG is not as significant as that of Intermountain Gas Company, Avista is partially constrained by its location. Whereas Intermountain Gas can rely heavily on gas coming out of the Rockies, which is priced artificially low due to transportation constraints, Avista's locational constraints require gas purchases primarily out of Canada. The weakening U.S. dollar and unfavorable exchange rate have caused an upward pressure on Avista's proposed WACOG. However, Avista's hedging practices, discussed below, have removed some of the price volatility and the proposed decrease, coupled with the decrease last year, will amount to meaningful savings to customers. The table below shows Avista's past and 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 (WACOG)	RESULTING TOTAL GENERAL SERVICE SCHEDULE 101 TARIFF, $/THERM	% CHANGE FROM PREVIOUS YEAR (Residential)
2002	0.34572	Base Year	0.75722	Base Year
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	0.76085	-0.91%	1.16175	-2.12%
2007 (Proposed)	0.75544	-0.71%	1.10560	-4.83%

Staff reported that Avista continues to follow its price stabilization practice of systematically fixing portions of gas costs using physical hedges and financial instruments in a purchasing program aimed at achieving a diversified gas supply portfolio. For the forthcoming PGA year, Avista plans to hedge approximately 70% of forecasted loads with a combination of fixed-price gas purchases/hedges executed throughout the year and scheduled withdrawals from available storage. Additionally, with the recent drop in forward prices, Avista has established price targets to execute hedges for an additional 5% of forecasted load, i.e., if forward prices fall to a certain level, Avista would execute these additional hedges.

The Company continues to follow the revised natural gas procurement program that it implemented approximately two years ago. While the program is fairly structured, it also allows for flexibility based on changing market conditions and continuous review by the Company. Last year, the Company implemented a change to provide additional rate stability for customers whereby 11% of supply is purchased each year at a three-year fixed-price. By the end of 2008, the Company will have approximately one-third of its gas supply purchased at staggered three-year fixed prices. Each year thereafter, the Company will purchase an additional 11% to replace the 11% contract(s) that expire. The resulting 33% purchased with three-year fixed-price 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 the Company's procurement program and to develop other hedging and purchasing practices with the intent of both stabilizing and reducing gas costs.

To quantify the impact of the Company's hedging practices for the previous PGA year, Staff compared the hedged price to the First of Month (FOM) index price and multiplied the difference by the hedged volume. For the period from July 1, 2006 through September 30, 2007, the Company's hedges were $9.9 million more than the FOM index. Although this measurement indicates that hedge prices were higher than the FOM index, the Company's hedging practices aim to mitigate volatility rather than secure the lowest price possible. While spot prices may occasionally be higher than hedge prices in the short-term, Staff believes the benefits of the Company's procurement policies and hedging practices are price stability designed to protect customers over the long-term.

Staff reviewed the customer notice and press release and recommends that the same were in compliance with the requirements of IDAPA 31.21.02.102. Customers and the general public were given until October 24, 2007, to file comments. As of October 26, 2007, no comments had been filed except those of Staff. Even though this year's PGA is a proposed decrease in natural gas rates, because some customers still struggle to pay their gas bills, Staff would like to remind qualified customers to take advantage of the energy assistance available through the federally-funded Low Income Home Energy Assistance Program (LIHEAP) and non-profit fuel funds such as Project Share. For more information on these programs, customers may call the nearest Community Action Agency, Avista Utilities, the Idaho Public Utilities Commission, or the 2-1-1 Idaho Care Telephone Line.

In summary, Staff recommended that the requested decrease in the WACOG, and the 12-month amortization of deferred expenses be approved. Staff recommended approval of the Company's Application and proposed tariff as filed. Staff also recommended that should rates be approved by FERC in the GTN rate case that are lower than those included in this case by Avista, that any and all refunds be credited back to Avista's customers.

COMMISSION DECISION

1. Does the Commission wish to approve Avista's Application and proposed tariff, including the requested WACOG and amortization of deferred expenses as filed by the Company and recommended by Staff?

2. Does the Commission wish to direct the Company to file further tariff decreases if the forecasted WACOG decreases materially or if the result of the pending FERC pipeline rate case for GTN results in transportation expenses significantly less that what the Company has included in its proposed tariffs?

3. Does the Commission wish to direct the Company to continue its monthly reporting of the changes and balances in the deferral accounts, and to continue reporting the WACOG quarterly?

DONOVAN E. WALKER

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