

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE SUBMISSION) CASE NO. AVU-E-02-6
OF THE STATUS REPORT OF AVISTA)
CORPORATION AND APPLICATION)
FOR A CONTINUATION OF A POWER)
COST ADJUSTMENT (PCA)) ORDER NO. 29130
SURCHARGE.)

On July 18, 2001, Avista Corporation dba Avista Utilities (Avista; Company) filed an Application with the Idaho Public Utilities Commission (Commission) in Case No. AVU-E-01-11 requesting authority to implement an electric Schedule 66 Power Cost Adjustment (PCA) surcharge. The surcharge would recover accrued PCA deferral balances resulting from a combination of record-low hydroelectric generation and unprecedented high wholesale market prices and volatility. The Company's Idaho PCA mechanism tracks 90% of the difference between actual net power supply expense and the authorized level of net power supply expense approved in the last general rate case. The Company's shareholders absorb the remaining 10% of the difference in net power costs. Net power supply expense is the total of purchased power expense plus fuel costs minus wholesale revenues. The balance in the Company's PCA deferral account for the Idaho jurisdiction at June 30, 2001 was \$30 million. The Company estimated that absent rate recovery, the deferral balance would increase to \$69 million by December 2001, \$72 million by the end of 2002 and \$88 million by the end of 2003. The Company requested a 27-month surcharge period through December 2003. The Commission in Order No. 28876 approved a 12-month surcharge of 19.4% (\$23.6 million) and directed the Company to file a Status Report 60 days prior to expiration of the authorized surcharge period, October 11, 2002. In its Order, the Commission stated, "if the Status Report and our review of the actual PCA deferral balance (at the end of 12 months) support continuation of the surcharge, we anticipate continuation of the surcharge for an additional period."

On August 9, 2002, Avista Corporation filed the Status Report required by Commission Order No. 28876. It also filed an additional Application requesting a continuation of the previously authorized PCA surcharge of 19.4%. As reflected in its filing, Avista states that the current status of the unrecovered PCA deferral balance as of June 30, 2002, was

\$45,600,228 for its Idaho jurisdiction. Avista requests that the Commission continue the PCA surcharge for an additional 12 months, through October 11, 2003.

In this Order the Commission approves a 12-month continuation of the existing 19.4% Schedule 66 PCA surcharge, the surcharge to expire in one year, i.e., October 11, 2003. We make adjustments to the PCA deferral account balance, defer decision pending further investigation on net fuel costs related to the Company's Coyote Springs facility, deny the Company's requested change in the PCA deferral balance interest rate, and direct Staff to investigate the Company's risk management policy and how it affects the Company's short-term resource acquisition decisions. Finally, we direct the Company to file a Status Report 60 days prior to expiration of the surcharge period.

STATUS REPORT – APPLICATION FOR EXTENSION

The details of the deferred cost balance as reflected in the Company's PCA account are as follows:

Deferral balance as of June 30, 2001	\$30,007,057
Deferrals July 2001 through June 2002	48,442,371
Transfer of under-rebate	(49,073)
Transfer of under-surcharge	342,069
PGE monetization accelerated amortization	(20,783,521)
Interest	<u>2,764,590</u>
SubTotal—Account 186.38 balance as of June 30, 2002	60,723,493
Revenues collected October 12, 2001—June 30, 2002	<u>(15,123,265)</u>
Unrecovered balance as of June 30, 2002	\$45,600,228

As reflected in the Company's previous PCA filing, hydroelectric generation through June 2001 for Avista was the lowest in the 73 years of record. The Company reports that it continued to experience those very low stream flow conditions through the remainder of 2001. The record low hydroelectric conditions in 2001, the Company states, required it to purchase energy in the forward short-term wholesale market to replace the lost generation and cover its energy deficiencies. These purchases, the Company contends, were made at unprecedented high wholesale market prices and caused deferral balances to increase substantially. The extraordinary power supply circumstances through mid-2001, especially the record low stream flows, the Company contends, continued to impact the Company's power cost deferral balances for the remainder of the year and into 2002. In fact, the Company states that of the deferrals of

\$48.4 million recorded between July 2001 and June 2002, approximately \$46 million occurred during the last half of 2001 with the remaining \$2 million occurring in the first half of 2002.

To mitigate the increased power costs, Avista states that it has increased operation of its thermal resources and has aggressively pursued conservation and load curtailment programs. However, the Company states that the costs associated with the hydroelectric conditions, the cost of short-term power market purchases and increased thermal fuel costs have exceeded the benefits these measures provided.

The Company contends that investor concern surrounding its cash flows, deferral balances, and the ability to recover costs in a timely manner have had an impact on the Company's finances that continues today. Avista's credit ratings are presently below investment grade and the rating agencies characterize the Company's outlook as negative. Avista points out that it is important for the Company to regain an investment grade rating as soon as possible so that longer-term debt can be refinanced on more reasonable terms, benefiting customers with lower debt-related costs. Credit ratings, the Company contends, will take time to restore and continuation of the current surcharge is one of the keys for Avista to continue to improve its financial condition.

Avista requests that the carrying charge or interest rate applied to the unamortized PCA deferral balance be increased from the current customer deposit rate to a level that is more reflective of the longer-term nature of the recovery period. Avista reports that the Company's embedded cost of debt as of June 30, 2002, is 8.88%, incorporating both long- and short-term debt. The Company proposes that the carrying charge be increased to a rate of 6%, as was recently authorized for Idaho Power Company.

The rates set forth under the Company proposed PCA Schedule 66 reflect an annual revenue surcharge amount of \$23.6 million, or 19.4%, a continuation of existing Schedule 66 rates. In comports with the existing surcharge recovery method, the surcharge amount will be recovered on a uniform percentage basis to all general service schedules and will apply only to the energy charge(s) within each schedule. The monetization and accelerated amortization of the Portland General Electric (PGE) Sale Agreement previously approved by the Commission is a \$2,309,280 per month offset to the PCA deferral balance that will continue to reduce the impact of the Company's PCA surcharge to customers through the end of 2002. After that point, the

ongoing PCA deferral entries will be adjusted to reflect the fact that the PGE credit has been fully returned to customers.

MODIFIED PROCEDURE – PUBLIC WORKSHOP – COMMENTS

On August 28, 2002, the Commission issued a Notice of Application in Case No. AVU-E-02-6. The Commission in its Notice determined that the public interest in this matter may not require a hearing to consider the issues presented and that the issues raised by the Company's filing may be processed under Modified Procedure, i.e., by written submission rather than by hearing. Reference Commission Rules of Procedure, IDAPA 31.01.01.201-204. The Commission established a September 18, 2002 deadline for filing written comments or protests.

On September 6, 2002, the Commission issued a second Notice scheduling a September 18, 2002 public workshop in Sandpoint, Idaho for Commission Staff to discuss issues related to the Company's Application and for Staff and the Company to answer questions from customers and interested parties. The Commission in its Notice extended the deadline for filing written comments on the Company's Application to September 20, 2002.

Written comments in this case were filed by Potlatch Corporation, Commission Staff, Stimson Lumber Company (Coeur d'Alene and Priest River), J D Lumber, Inc. (Priest River), Regulus Stud Mills (St. Maries), the County of Shoshone, Tri-Pro Cedar Products (Old Town), Senator Shawn Keough, and a number of the Company's electric customers. Idaho Legislators who attended the public workshop were Senator Shawn Keough and Representatives John Campbell and George Eskridge. The comments filed with the Commission can be summarized as follows:

Commission Staff

Staff filed both original and supplemental comments. Staff's review covered expenses incurred for the period July 2001 through June 2002 and included a representative sampling or cross section of transactions in the Purchased Power (FERC 555) and Power Sales (FERC 447) accounts. Specifically reviewed was the price of a transaction when executed compared to other relevant purchase/sales prices (Mid-Columbia index and futures) available at the time. Based on its review, Staff concludes that the Company's purchases and sales transactions appear reasonable and competitive with other alternatives based on information available to the Company at the time of the transactions.

Included in the previous PCA period, Staff notes, were the Buy-back programs approved by the Commission. Buy-back expenditures of \$2,169,263 were incurred during July through December 2001 in this PCA period. At Avista's request, the programs were cancelled when they became uneconomical. Staff verified that the amounts are correct and were recorded appropriately.

The largest component of the above normal power supply costs deferred during the July 2001 through June 2002 time period, Staff notes, were purchase/sales transactions. The Company quantifies above normal purchase power costs of approximately \$39 million with offsetting market sales of approximately \$8.4 million. These market transactions, Staff notes, net to approximately \$30.6 million of the \$48.4 million of the above normal power supply deferrals booked in the year currently being reviewed. Staff reviewed the reasons for the additional power supply costs provided by the Company, poor water conditions and high market prices, and found them to be generally true.

Staff notes that day-ahead market prices peaked in December 2000 and declined to less than \$100 per megawatt hour in June 2001, the month before the current period being audited began. It took several more months for the price to return to the \$20 to \$30 per megawatt hour level that was normal before the price run up. During the first two months of the current PCA period, Staff notes that Avista continued to purchase energy from the day-ahead market at abnormally high prices. The Company also continued to incur abnormally high-energy costs associated with forward energy purchases made prior to market price declines that began in June 2001. The Company's current risk management policy, in place at the time the forward energy purchases were made, establishes specific deadlines for addressing load/resource imbalances. Projected imbalances 1) can be fairly large one year ahead of need, 2) must be significantly reduced six months ahead of need and 3) must be completely eliminated one day ahead of need. This risk management policy, Staff notes, required the Company to make substantial energy purchases to serve needs for the second half of 2001 at pre-June 2001 prices.

Staff reviewed the Company's Risk Management Policy, a sample of the Company's "Position Reports" showing load/resource positions and "Deal Tickets" that identify purchase and sales quantities, prices and dates. Staff believes that the 90/10 sharing of the above normal power supply costs in this PCA filing provides the Company with an economic incentive to make the best possible decision for customers. Staff concludes that the Company's market

purchase and sales decisions were reasonably based on good utility practice and information available at the time the decisions were made.

Interest

Staff notes that the Company is currently using the customer deposit rate to calculate the interest on the deferral balance. Staff recommends that the Company continue to use the customer deposit rate which is currently 4% and is adjusted annually on the first of January.

Staff notes that while Idaho Power and Avista have similar PCAs, Idaho Power's PCA deferral balance accumulates interest only when the power supply costs are being deferred. Once those costs are subject to recovery, interest is no longer calculated on the remaining deferral balance. Avista's PCA deferral balance continues to accrue interest while the deferred power costs are being recovered in addition to receiving interest while the costs were being deferred. Receiving interest on the deferral balance during the recovery period provides Avista with additional compensation for costs incurred. This difference in PCA mechanisms, Staff contends, provides Avista with sufficient carrying charge recovery, making a change from the customer deposit rate unnecessary.

Small Generation Options

Staff notes that Avista pursued various generation projects that enabled it to avoid additional high-cost purchases of energy from the short-term wholesale markets when the projects represented the lowest cost resource options available at the time. These projects included Boulder Park – \$8,423 (six gas-fired reciprocating engines –25 MW), Devil's Gap – \$2,593,656 (lease costs for 20 diesel generators), Kettle Falls Bi-Fuel – \$384,856 (lease costs for temporary generators), and Othello – \$892,131 (23 MW combustion turbine – cancelled). In addition to adding generation, the Company, Staff notes, was able to increase its operation of the Northeast Combustion Turbines (\$36,320). The Company also stopped the spill at its Monroe Street generating station on the Spokane River thereby increasing its hydro generation. In so doing, the Company incurred liability to Spokane for loss of revenue at the City's gondola ride (\$4,666). With the exception of the included capital costs related to Kettle Falls (\$56,598), Devils Gap (\$96,743), and the Othello project (\$744,884), Staff believes the expenses incurred to operate these projects should be included in the PCA and recommends approval of expense recovery through the PCA subject to the 90/10 customer/company sharing provisions.

Net Fuel Expense

Staff notes that the Company's filing also includes net fuel expense for the natural gas combustion turbine fuel purchased, but sold rather than burned. The Company purchased natural gas on the forward market for use in its leased and owned combustion turbine units. The Company's decision to purchase natural gas was made at a time when the forward market price for energy was much higher than the cost of gas fired generation. Based on information available at the time, Staff concludes that the Company's forward gas purchase decisions were reasonable. To the extent purchased gas was not used to generate electricity, it was sold by the Company into the market. After the purchases were made, Staff notes that market energy prices began to decline. It became more cost effective to purchase energy from the market than to generate using previously purchased gas.

Staff does not dispute the Company's decision to purchase gas to meet future needs. Nor does Staff dispute the Company's decision to sell unused gas and rely on purchases from the energy market when declining prices made it more cost effective. However, Staff believes that Avista must better explain elements of its risk evaluation methodology that drives the Company's short-term resource acquisition decision-making. For example, Staff contends that the Company needs to describe the criteria used to first establish its natural gas fuel portfolio and then to determine the timing of its divestiture. Staff proposes further investigation by working with the Company to identify and document the process used in this area of decision-making.

In addition, Staff continues to have questions regarding the circumstances surrounding acquisitions and then dispensation of natural gas to fuel the Coyote Springs combined cycle combustion turbine. The Company maintains that at the time natural gas was purchased, it was anticipated that Coyote Springs II would be operational and more economical to operate than making market energy purchases. As it turns out, Coyote Springs was neither operational nor economical given the price of gas previously purchased. The effect was an abnormally high percentage of hedged gas to serve available resources at prices found to be uneconomical when compared to energy purchased from the market. Consequently, Staff proposes that the Commission withhold judgment on net gas costs of \$578,748 incurred in June 2002 to serve Coyote Springs until a more complete evaluation is conducted regarding anticipated online dates, reasons for the operational delay and timing of the sale of gas acquired

for use at the plant. Staff believes that the additional evaluation can be conducted by Staff and included for review in the next PCA.

Gas Swaps and Financial Accounting Standards (FAS) 133

Staff recommends the removal of the line item labeled gas swaps and FAS 133. Avista includes two equal and opposite entries in the deferral balance, one in December 2001, and one in January 2002. Staff contends that the entries are a tracking mechanism for derivative accounting with FAS 133 and are not appropriate PCA items. There is no change in the deferral balance as a result of these entries or Staff's adjustment.

Rate Decision—Extension of Deferral Period

Staff notes that at the public workshop three commercial customers involved in the timber industry voiced concerns about the PCA rate impact on their costs. One customer (J D Lumber, Inc.) suggested that spreading PCA costs over two to three years would be more beneficial. Staff recognizes this as a rate design option but does not recommend this option to the Commission for the following reasons: Quantified PCA deferrals will require two years to recover under the Staff and Company proposals in this case. Delaying recovery of these deferrals further into the future brings the possibility of additional years of poor water conditions, which could increase the deferral balance. The carry-over balance would accrue additional interest charges, which would increase PCA rates for those customers. It is also a concern that these customers only represent three customers in one or more classes. It is not known whether or not other customers in the same customer class or classes would want PCA costs spread over additional time periods.

Staff Calculation of the Deferral Balance

The Company reports a total unrecovered deferral balance at June 20, 2002 of \$45,600,228. Staff adjustments total \$1,499,932 and result in a total unrecovered deferral balance at June 30, 2002 of \$44,100,296. Staff supports the Company's proposal to leave current rates in place for another year and proposes to re-examine PCA deferrals next year. Staff recommends that the Company be required to file a PCA status report 60 days prior to the expiration of the PCA rate.

Consumer Issues

Staff in its comments summarizes the written comments received from customers, comments presented in the September 18 workshop in Sandpoint and details the different types of programs available to customers for energy assistance and payment.

Staff Recommends:

1. That the current surcharge of 19.4% be continued for another 12 months and the Company be required to file a PCA status report 60 days prior to the expiration of the PCA rate next year.
2. That the Company's request to change the interest rate be denied and the existing rate be continued. The interest rate mechanism as originally applied in the PCA modification case – using the customer deposit rate, continues to be the appropriate rate in determining the carrying charge.
3. That the variable costs for the small generation options be included in the deferral balance for recovery. The costs included in the deferral balance that represent capital costs, i.e. for the Kettle Falls small generation option, should be excluded from deferral balance and subsequent recovery.
4. That the net fuel expense for natural gas combustion turbine fuel sold rather than burned be included in the deferral balance for recovery, with the exception of the net expenses that were specifically related to fuel expenses for the Coyote Springs plant. Staff recommends these expenses along with similar expenses incurred after June 2002 be subject to a more detailed evaluation to be completed by Staff and reflected in the next PCA review.

Staff also proposes a complete review of Avista's risk management and mitigation policies on an ongoing basis. A review of these types of transactions, it contends, is timely given the changes in electric and gas markets along with changes in the electric industry. It is also, it states, consistent with reviews conducted with other utilities.

5. That the line item titled Gas Swaps, FAS 133 included by the Company in the deferral calculation be removed.
6. That the deferral balance be modified to include Staff's adjustments and the corresponding adjustments to the carrying charges.

Potlatch Corporation

Potlatch contends that Modified Procedure is not appropriate because the Application raises a number of very significant issues that are well beyond the scope of a traditional PCA pass-through case. Potlatch recommends that the Commission conduct an evidentiary hearing.

Potlatch contends that the real reason for Avista's enormous power cost deferrals during the period from July 2001 through June 2002 was its decision to lock-in forward prices shortly before the market's rapid price decline. Potlatch also notes that Avista's losses from hedging comprise more than 25% of the Company's PCA request. This expense was for natural gas purchases intended for use in generating electricity, but not actually used for generation but resold into the open market. Potlatch states that this natural gas was resold by Avista at an enormous loss equal to more than 40% of the original purchase price. On its face, Potlatch contends that this huge purchasing mistake cries out for a prudency investigation.

Potlatch argues that Avista's attempt to recover nearly \$750,000 in net turbine costs for the cancelled Othello project is objectionable because the turbine is not "used and useful" in the service of Idaho ratepayers. In addition, Potlatch notes that Avista proposes to recover "lease payments, maintenance agreement payments, and incremental, non-labor, installation costs for Devil's Gap and Kettle Falls Bi-Fuel." Such costs, Potlatch contends, cannot be deferred for PCA recovery, whether or not prudently incurred. Citing Idaho Power Case No. IPC-E-02-7. Such plant costs must be recovered, if at all, Potlatch contends, in a general rate case.

Potlatch questions whether Avista is allocating the cost of serving Potlatch inappropriately. Avista's Application, it states, contains an unusual direct assignment to the Idaho jurisdiction of the cost of serving Potlatch. If Avista directly assigned a pro rata share of the system cost of service to Potlatch to the Idaho jurisdiction, then Potlatch concedes that the assignment appears to be proper. If, on the other hand, Avista assigned anything other than a pro rata share of system costs, then Potlatch contends that the assignment is improper and potentially detrimental to Idaho ratepayers. Without further proceedings, Potlatch states that it cannot determine whether this assignment is proper or not.

Potlatch requests that the Commission either (1) deny Avista's request for continuation of the PCA surcharge or (2) limit refundable recovery to the PCA amounts that would have been incurred had Avista made its electric and natural gas purchases at actual

contemporaneous wholesale market prices, as measured by prices at Mid-C and at Sumas, Washington.

Other Customer Comments

With the exception of two customers who support the Company's filing, the comments filed by the Company's other customers express opposition to a continuance of the PCA surcharge. The temporary surcharge is a hardship and they would like to see it removed. It was suggested that Commission efforts to address and better the financial wellness of the utility must be weighed against the effect of those efforts in what is already a stagnant and depressed economy. For many timber related businesses in northern Idaho, the cost of power is a significant expense. The added cost and effect of surcharges, they state, can be staggering.

A great many comments reflect that the Company has been unsuccessful in communicating the separateness of its regulated utility operations from its unregulated subsidiary operations. Both customers and some legislators alike believe that there is a direct tie to the actions of Avista's subsidiaries and the increase in electric costs that the utility seeks to pass on to its customers. The Commission is urged to take no action until the Federal Energy Regulatory Commission (FERC) completes its investigation of the 2000-2001 run-up in northwest and western market energy prices.

Avista and not its customers, some contend, must be held responsible and accountable for the bad decisions of its management. The Company, one customer comments, should stay committed to being a utility company and stay away from other money deals, which may be harmful. The Company, it was suggested, needs to put time and effort into cutting its costs, and should by example require the CEO and other top executives to take a reduction in their bonuses, stock options and other benefits.

Company Reply

Avista contends that Potlatch's request for evidentiary hearings should be rejected. Avista states that the issues raised by Potlatch in their comments are premised on inappropriately applying "hindsight" to power purchase, gas purchase and small generation project decisions made by Avista to serve its customers. The appropriate standard, Avista contends, is whether the Company made a reasonable decision based on the information available to the Company at the time the decision was made. Avista contends that it is not appropriate to compare purchase prices to historical indexes and prices.

Avista also disagrees with Potlatch's comments with regard to capital costs for completed and cancelled small generation projects. Capital costs associated with the recently completed Company-owned Boulder Park generating project, Avista contends, are not included in the PCA. The Kettle Falls Bi-Fuel units, the Company states, are leased units which addressed resource needs that cost less than then prevailing market prices and, the Company contends, are appropriately included in the PCA.

The Devil's Gap small generation option, the Company states, was for the lease of diesel generators. The lease was cancelled due to the subsequent decline in market prices. The Company disagrees with Staff's proposal to remove site preparation and setup costs associated with the lease units under the premise that such costs are capital costs. These costs, the Company states, were necessary in siting the lease units. The Company submits that the costs were necessary, prudently incurred, and should remain in the PCA deferral.

The Othello small generation project, the Company states, was originally planned to be owned by the Company, but the project was cancelled and the costs included in the PCA represents the write-down of the value of the unit. Othello project write-down costs, the Company contends, are not capital costs from the standpoint of being a completed plant that is currently in service. The Company contends that the Staff mischaracterizes the Othello project as lease costs. The Company believes that regardless of how the write-down is characterized, the costs were reasonably incurred by the Company to reduce the overall power costs based on conditions at the time and should be included in the PCA.

Should the Commission decide that it is appropriate to remove the Othello write-down costs from the PCA deferral balance the Company requests that the Commission permit the Company to record the costs in Account 182.30 Other Regulatory Assets to be held for review until its next general rate case. Absent Commission authority for deferral as a regulatory asset, the Company notes that it could be put in a position of expensing the Othello write-down as a current period cost.

Avista maintains that Potlatch's contention that the direct assignment to Idaho of the cost in serving Potlatch may be inappropriate is without merit. With the exception of the previous Potlatch contract on December 31, 2001, Avista states that Potlatch received service under the Idaho Extra Large Service – Schedule 25 rate schedule. The direct assignment of 25 aMW of Potlatch load to Idaho, the Company contends, is necessary, as the

production/transmission allocation does not reflect the new service under Schedule 25. Reference Application, Norwood Testimony pp. 19-21. Mr. Norwood's testimony, the Company states, shows the Idaho PCA benefit of the Potlatch contract change to be \$1,365,540. The cost of \$30 per megawatt hour was used for the direct assignment cost for the 25 average megawatts. The \$30 per megawatt hour price, the Company contends, is close to the average system cost of power. Therefore, contrary to Potlatch's allegations, Avista contends that the \$30 price per megawatt hour is a fair representation of average system cost and that there is substantial benefit to Idaho customers.

COMMISSION FINDINGS

The Commission has reviewed and considered the filings of record, PCA Status Report and comments in the Company's Application to extend the existing PCA surcharge for an additional 12 months, including the comments of Senator Keough, the Commissioners of Shoshone County, Potlatch Corporation and Commission Staff. We have also reviewed our prior Order No. 28876 wherein we authorized the present PCA surcharge, required the Company to file a Status Report prior to its scheduled expiration, and anticipated a filing by the Company requesting a continuation of the surcharge. A continuation was anticipated because the 19.4% surcharge requested by Avista and approved by the Commission would generate only \$23.6 million, less than the accrued balance in the PCA deferral account (\$30 million) at the time the surcharge was implemented. Although the Company requested a 27-month surcharge period, we approved only 12 months. We implemented a surcharge based on actual deferral balances. The power situation in the Northwest continued to be unsettled. The prospect of future volatility dictated that we closely monitor the Company's purchase power and power sales decisions. The Company's filing in this case provides us with the opportunity to revisit the Company's PCA deferral account, its hydro position and its related power purchase/sale transactions.

This filing by the Company is a continuation of last year's PCA filing, a filing that was precipitated by a combination of record low hydroelectric generation and unprecedented prices for short-term wholesale electricity and natural gas. It was an energy crisis of historic proportion. Regulators and utilities are still struggling with its impacts. The 27-month recovery period requested for accrued and estimated power cost deferrals spread the recovery of those costs over time to allow a lower surcharge level than would otherwise be required. The Company's initial estimate of future deferrals has proven to be fairly accurate. We established a

12-month recovery period, required a Status Report and pledged to revisit the matter in a year. We note that the Company last year anticipated offsetting some of the accrued power purchase costs with market sales of its own surplus generation. The market rate and level of offset that Avista hoped to receive was dampened by the cap on market rates imposed by FERC and current market rates.

Many of the concerns and issues raised by Avista's customers fall outside the limited scope of a PCA filing, which is limited to power cost transactions and expenses, variable costs related to the Company's generation capability, and related efforts necessary to serve and benefit its native load. In assessing the reasonableness of the Company's deferred costs we consider whether the Company's decisions based on the information available at the time were reasonable when made and whether the Company's attempts to control its costs were prudent. It would not be appropriate to use the review standard suggested by Potlatch and assess the Company's decisions from the perspective of perfect hindsight. The Company hedged against future price volatility with forward energy and gas purchases. Although circumstances ultimately created unfortunate results, we find the utility's practice to be otherwise responsible and reasonable.

Some of the issues raised by customers in comments are beyond our statutory jurisdiction, which is defined by Idaho Code, Title 61. Our jurisdiction over the activities of the regulated utility affiliates is limited. Some of the issues raised by customers fall within the jurisdiction of the Federal Energy Regulatory Commission (FERC), an agency which itself is conducting an investigation of utilities and traders regarding the wholesale market pricing and energy situation which developed in 2000-2001.

Potlatch in its comments requested an evidentiary hearing. We find no need for such a hearing. We continue to find Modified Procedure to be appropriate. The level of the Company's PCA deferral balance (\$45 million) and the annual surcharge rate requested (\$23.6 million) permit us to make adjustments and conduct further inquiry without suspending or reducing the surcharge. In this Order, we exclude the recovery of capital costs identified by Potlatch as inappropriate for a PCA mechanism. We also defer a decision regarding fuel costs for Coyote Springs pending further inquiry and direct Staff to investigate the Company's Risk Management Plan.

Although some adjustments to the PCA deferral balance are appropriate, based on Staff's audit results, the Commission finds it is reasonable to authorize a one-year continuation

of the existing 19.4% (\$26.6 million) surcharge. The bulk of the deferred PCA amounts continue to be purchase/sales transactions related to poor water conditions and high market prices. Also included are amounts associated with Commission authorized buy-back programs and net fuel costs for the Company's natural gas combustion turbines, gas that was purchased, but because of more competitive least-cost options not used and sold at a loss. We find that no adjustment is required related to the Company's cost of service to Potlatch and its transition from special contract customer to tariff customer. We acknowledge an adjusted unrecovered balance at June 30, 2002 of \$44,100,296. See Attachment A to this Order.

As a regulatory body, this Commission has a dual obligation, to the utility and to its customers. We cannot deny recovery of reasonably incurred expenses. The rates we approve must be just and reasonable. We cannot establish rates for the Company that are confiscatory. The Commission has the power to investigate the reasonableness of the Company's request. As we noted in the Company's prior PCA filing, not all factors contributing to the increase in the PCA deferral balance are beyond the control of the Company. Avista controls the timing of its purchases, controls the extent to which it hedges against price changes, and controls the extent to which the Company is in a net deficit resource position.

We find that the PCA mechanism is for recovery of variable costs and is not an appropriate vehicle for recovery of capital costs. Accordingly, we direct the Company to remove the capital costs associated with Kettle Falls Bi-Fuel (\$56,598), Devil's Gap (\$96,743), and Othello (\$744,884) from the PCA deferral accounts together with corresponding adjustments to the carrying charges. See Attachment A to this Order.

Staff and Potlatch both suggest the appropriateness of further inquiry regarding fuel purchased for the Coyote Springs plant. We agree. We remove \$578,748 in net fuel expense pending further review together with an adjustment for related carrying charges. See Attachment A to this Order. We find it reasonable that the inquiry and Staff's investigation be conducted during the next surcharge year and reported during the next PCA review. We find that it is also appropriate during this next year for Staff to investigate and assess the reasonableness of the Company's risk management policy and how it affects the Company's short term resource acquisition decision making and to submit its findings and conclusions during the next PCA review.

Avista has requested authorization of a 6% interest rate on deferral balances. Although we granted that rate to Idaho Power, the PCA methodologies for the two companies and their treatment of carrying charges are different. The PCA deferral balance for Avista accrues interest during the recovery period; Idaho Power's does not. We therefore find it reasonable to deny Avista's request. The Company is to continue using the annually adjusted customer deposit rate, currently 4%, a rate that we continue to find reasonable.

Regarding the Company's inclusion of a line item labeled Gas Swaps and FAS 133 in its PCA accounts, the Commission finds that inclusion of a tracking mechanism for derivative accounting in the PCA accounts is inappropriate. The Company is directed to remove those line entries.

As we did last year, we find it reasonable to continue a close monitoring of the Company's PCA decisions and thus require the Company to file a PCA Status Report 60 days prior to the expiration of the PCA surcharge. As before, if the Status Report and our review of the actual PCA deferral balance supports continuation of the surcharge, we anticipate continuation of the surcharge for an additional term.

In authorizing a continuation of the surcharge, we recognize that the Company's residential, small business and industrial customers will not have the rate relief that they desire. For some customers this will result in economic hardship. We are not insensitive to their situation. Staff in its comments has detailed different types of programs available to eligible Avista customers for energy assistance and payment, i.e., (1) the LIHEAP energy assistance program, (2) Project Share, (3) County welfare benefits, (4) the CARES program which assists elderly and disabled customers, (5) Avista's comfort level billing program, and (6) a winter moratorium on disconnects. Those comments are available on the Commission's website, www.puc.state.id.us, under this case number. Direct inquiry can also be made of the Company at call center numbers identified in monthly billing statements.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over Avista Corporation dba Avista Utilities and the issues raised in Case No. AVU-E-02-6 pursuant to the authority granted the Commission in Idaho Code, Title 61 and pursuant to the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

ORDER

In consideration of the foregoing and as more particularly described above, IT IS HEREBY ORDERED and the Commission does hereby authorize a continued 12-month PCA surcharge of 19.4% (\$23.6 million) for an effective date of October 12, 2002. Avista is directed to file a PCA Status Report 60 days prior to expiration of the authorized surcharge period.

IT IS FURTHER ORDERED that the Avista requested change in the interest rate on the PCA deferral balance is denied.

IT IS FURTHER ORDERED that capital costs (and related carrying charges) included by the Company in the variable costs for small generator options be excluded from any PCA recovery. See Attachment A to this Order.

IT IS FURTHER ORDERED and the Commission defers decision regarding the net fuel expense (and related carrying charges) related to the Company's Coyote Springs facility pending further inquiry and report to the Commission in the Company's next PCA review.

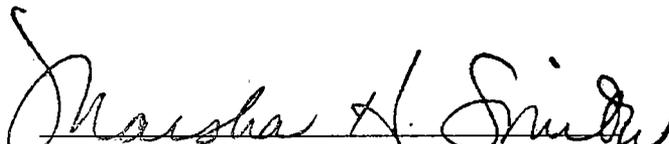
IT IS FURTHER ORDERED and Staff is directed to investigate and assess the reasonableness of Avista's risk management policy and how it affects the Company's short-term resource acquisition decisions and to submit its findings and conclusions in the Company's next PCA review.

IT IS FURTHER ORDERED that the line item titled Gas Swaps, FAS 133 included in the Company's PCA accounts and deferral calculation be removed.

THIS IS A FINAL ORDER. Any person interested in this Order may petition for reconsideration within twenty-one (21) days of the service date of this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

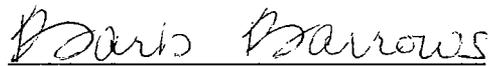
DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 11th
day of October 2002.


PAUL KJELLANDER, PRESIDENT


MARSHA H. SMITH, COMMISSIONER


DENNIS S. HANSEN, COMMISSIONER

ATTEST:


Barb Barrows
Assistant Commission Secretary

bls/O:AVUE0206_sw

**Idaho Public Utilities Commission
Staff Attachment A
Avista Idaho PCA Deferred Cost Balances
Case No. AVU-E-02-06**

1 Deferral balance at June 31, 2001	\$ 30,007,057
2 Deferrals July 2001 through June 2002	\$ 48,442,371
3 Transfer of under-rebate	\$ (49,073)
4 Transfer of under-surcharge	\$ 342,069
5 PGE monetization accelerated amortization	\$ (20,783,521)
6 Interest	<u>\$ 2,764,590</u>
7 Subtotal - Account 186.38 balance at June 30, 2002	\$ 60,723,493
8 Revenues collected October 12, 2001 - June 30, 2002	\$ (15,123,265)
9 Unrecovered balance at June 30, 2002	<u>\$ 45,600,228</u>

(Avista Application; Page 4, Lines 8 through 16)

Staff Adjustments to Deferrals July 2001 through June 2002

10 Remove the Kettle Falls Bi-Fuel Capital Costs	\$ 56,598
11 Remove the Devil's Gap Capital Costs	\$ 96,743
12 Remove the Othello Capital Costs	<u>\$ 744,884</u>
13 Subtotal - Capital Costs	\$ 898,225
14	
15 Defer the review of the Net Fuel Expense for June 2002 for fuel purchased specifically for Coyote Springs	\$ 578,748
16	
17 Adjustment to Interest balance as a result of Staff Adjustments	<u>\$ 22,959</u>
18 (July 2002 will reflect the interest adjustment for the June 2002 Staff Adjustments)	
19	
20 Total Staff Adjustments	<u>\$ 1,499,932</u>
21	
22 Staff Unrecovered Balance at June 30, 2002	<u>\$ 44,100,296</u>