BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1286

Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's Three Local Distribution Companies	Avista's Reply Comments

Avista (company) submits these reply comments in response to the initial comments filed by the Parties in this proceeding addressing PGA incentive mechanisms. In these reply comments, the company will: 1) address certain comments and proposals made by the other Parties, 2) identify common themes among the initial comments, and 3) briefly review the company's position on PGA incentive mechanisms. Lastly, the company will address the Commission Staff's (Staff) proposal for more frequent PGA filings, and why the company believes that this proposal should not be adopted by the Commission.

CUB's Deadband Proposal

CUB proposes to retain the current PGA sharing mechanism and implement a deadband, whereby, the LDC would be 100% at risk for total gas cost variations within a predetermined financial range. The Staff, Northwest Industrial Gas Users (NWIGU) and Northwest Natural (NWN) all opposed implementation of a deadband in their initial comments. Avista joins with these other Parties in opposition of a deadband. We will not belabor the points made by the other Parties but strongly agree with their position that: 1) there are fundamental differences between natural gas and electric utilities (where a deadband has been used for power cost differences), and 2) a deadband could place too much financial risk on the LDC. Implementation of a deadband would cause the LDCs to search for ways to minimize the potential financial risk represented by the deadband, such as purchasing options or contracting for additional gas supply at fixed prices to cover the risk of high load requirements during abnormal weather. Even NWN, who has substantial underground storage which can be utilized to displace high-cost gas purchases during cold weather, opposes implementation of a deadband.

Current PGA Gas Cost Sharing Mechanism

With regard to the current gas-cost sharing mechanism, only CUB and NWN support retention of the mechanism with modifications. As previously mentioned, CUB supports retention of the mechanism with the implementation of a deadband. NWN supports retention of the current mechanism with a modification of their sharing percentage from a 67%(customers) / 33%(shareholders) to an 80/20. On page 15 of their opening comments, lines 14-16 they state: "An LDC like NW Natural can seek to manage its spot purchase volume and price volatility - due to weather and other market fluctuations - relative to the PGA forecast by optimizing its use of storage." Additionally, on page 18, lines 17-19 they state: "NW Natural maintains significant storage capacity and therefore is better able to manage short-term market volatility than the other LDCs who have less access to storage." Herein lies a major difference between the Oregon LDCs, and why the current sharing mechanism "works" for NWN, but does not for Avista and Cascade (who have less access to storage).

The opening comments of Staff, Avista, Cascade and NWIGU all discuss the primary issues associated with the current sharing mechanism as applied to the LDCs in today's natural gas market. These primary issues are: 1) the current mechanism encourages the LDCs (especially those with less storage capacity) to hedge a majority of their estimated gas requirements, and 2) the difficulty in establishing the estimated price for unhedged volumes in the PGA. Both of these issues/factors affect the amount of potential financial risk the LDCs will be exposed to in the ensuing PGA year. On page 19 of NWN's opening comments, lines 3-5 they state: "The Commission and parties understand the current mechanism and it is applied without difficulty." Based on the opening comments of the parties noted above, as well as numerous comments made in recent Staff PGA memos and UM 1282 (investigation into Avista's hedging practices), clearly, the current (sharing) mechanism is applied with *great* difficulty.

Avista, Cascade and Staff

Avista, Cascade and Staff all propose elimination of the present gas-cost sharing mechanism and support a 100% pass-through of prudently incurred gas costs in their opening comments. While both Avista and Cascade do not support the use of *any* gas cost incentive mechanism, Staff proposes implementation of two Gas Purchase Incentive Mechanisms (GPIMs). While Staff's proposed GPIMs are preferable to the present sharing mechanism, even Staff states on page 11 of their comments, that there are "difficulties" with the design of the first mechanism and later admits that their second mechanism is considerably more complex than the first. However, perhaps the biggest issue that the company sees with Staff's proposed GPIMs, or any GPIM for that matter, is not even mentioned as an issue by Staff in its comments. This issue is the establishment of appropriate external "benchmarks" from which to compare the LDC's natural gas purchases to. Under Staff's first proposed GPIM, which would apply only to short-term (monthly and daily) gas purchases, the LDC's (weighted) price for gas purchased during a month is compared to the benchmark price for that month. Staff is silent on how the benchmark is established. As described in the company's opening comments, gas prices at the various basins/delivery points change continually throughout each and every day, which would make establishment of reasonable benchmarks difficult and problematic.

Staff's second GPIM also includes long-term purchases (hedges), whereby the LDC's actual WACOG is compared to a "benchmark WACOG". Again, the derivation of the benchmark is not described. The company would not support implementation of these, or any GPIM, until there is a fair and equitable resolution of all issues.

Additional Prudency Requirements - No Need for Incentive Mechanism

Nearly all of the Parties state in their opening comments that, with or without an incentive mechanism, there is still a need for a prudence review of each LDC's gas costs and purchasing practices. The second phase of this proceeding will address additional guidelines and documentation related to this issue. Staff even has a separate section in their opening comments with recommendations related to a more rigorous prudence review. The company does not oppose additional requirements that are reasonable - for example, over the past year, the company has corresponded regularly with Staff and provided information on an on-going basis regarding its gas procurement activities.

The question then becomes: With additional guidelines and documentation required to support the LDC's gas procurement activities, is there really a need for a gas-cost sharing or incentive mechanism? The company believes the answer is an unequivocal "no". As stated in the company's opening comments, the time spent debating, designing, implementing and monitoring *any* incentive mechanism could be better spent sharing information related to gas costs and procurement activities, the extent of which will be further discussed in the second phase of this proceeding.

More Frequent PGA Filings

In the Staff's opening comments, they recommend more frequent (quarterly) PGA filings by the LDCs. The company disagrees with this recommendation. A primary benefit of annual PGA filings is to provide a reasonable level of price stability to customers by reducing the short-term price volatility that exists in the market. More frequent PGA filings would certainly result in less price stability. Staff states that more frequent PGA filings provide more "real time" pricing signals to customers and helps customers adjust their usage accordingly. As we have seen in recent years, the price of natural gas can have huge swings, both up and down, throughout a year. With the level of volatility we have seen in the natural gas market, "real time" pricing signals would certainly lead to larger, more frequent price swings and greater customer confusion. Further, it is doubtful whether customers can adjust their usage "accordingly" in response to more volatile prices, as suggested by Staff. Annual PGA filings can, and generally do, provide the *right* price signal to customers, without the short-term market volatility.

Staff provides several other reasons supporting more frequent PGA filings that are all essentially about sharing and providing timely information regarding gas markets, gas costs and procurement practices. This information can be provided without the need for more frequent PGA filings and, in fact, will be addressed in detail in the second phase of this proceeding.

Summary

In the initial comments filed by the Parties in this proceeding, only CUB and NWN support retention of the current gas-cost sharing mechanism (with modifications). CUB proposes implementation of a deadband, which carries too much financial risk for the LDCs, and is opposed by all other Parties. NWN has a substantial amount of gas storage which can be used to manage its financial risk under the current mechanism; Avista and Cascade have only relatively small amounts of storage and are subject to much greater risk under the current sharing mechanism.

Avista, Cascade and Staff all propose elimination of the present gas-cost sharing mechanism and support a 100% pass-through of prudently incurred gas costs. Staff proposes implementation of two GPIMs and, while preferable to the present sharing mechanism, the company would not support implementation of these, or any GPIM, unless it is fair and equitable.

Nearly all of the Parties state in their opening comments that, with or without an incentive mechanism, there is still a need for a prudence review of each LDC's gas costs and purchasing practices. With additional guidelines and documentation required to support the LDC's gas procurement activities (which will be the topic in the second phase of this proceeding), the company believes that there is no need for an incentive mechanism.

Lastly, the Commission should reject the Staff's recommendation for more frequent PGA filings. More frequent PGA filings would result in more volatile prices to customers and additional customer confusion. The additional information that the Staff is looking for in these filings can be gained without more frequent rate changes and additional price volatility to customers.

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January 28, 2008

Oregon Public Utility Commission
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RE: UM 1286

Dear Filing Center:

Enclosed for filing please find a copy of Avista's reply comments in Phase 1 of docket UM 1286.

If you have any questions regarding this filing, please contact Brian Hirschkorn at 509-495-4723.

Sincerely,

Kelly Norwood

Kelly O. Norwood, Vice President
State and Federal Regulation

Enc.
cc: UM 1286 Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have served Avista Corporation's Reply Comments in Phase 1 of Docket UM 1286, by electronic mail and by mailing a copy, where paper service has not been waived, to the following:

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Dated at Spokane, Washington this 28th day of January 2008.

Patty Olsness

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Rates Coordinator