

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1282

In the Matter of)
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THE PUBLIC UTILITY COMMISSION)
OF OREGON,)
)
Investigation pursuant to ORS 757.210 and)
ORS 757.215 to examine Avista Corp., dba)
Avista Utilities' gas purchasing strategy.)
_____)

OPENING BRIEF
OF THE
CITIZENS' UTILITY BOARD OF OREGON

May 1, 2007



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I. Introduction

Staff requested that the Commission open this docket to investigate the prudence of Avista’s gas procurement strategy for the 2006-2007 gas year. Staff, the Northwest Industrial Gas Users (NWIGU), and Avista (hereinafter the “Parties”) filed the Stipulation for the purpose of resolving the imprudence issues in this docket. The Stipulation contains provisions that are appropriate and adequate to resolve the issue of Avista’s imprudence, specifically, a rate credit to address the past imprudence, and documentation protocols to avert future imprudence. Unfortunately, the Stipulation also contains a proposed modification to the Company’s purchased gas adjustment mechanism (PGA) which is not an appropriate imprudence remedy and is an inappropriate policy change to make in a prudence review docket. This is especially true in light of the Commission’s currently-open docket, UM 1286, specifically geared to investigate the gas

utilities' PGA mechanisms. CUB recommends that the Commission reject the Stipulation as filed, and request that all the parties instead consider the Stipulation with the PGA change removed as a resolution of Avista's 2006-2007 imprudence.

II. Argument

A. A Prudence Review Is An Inappropriate Place To Modify The PGA Mechanism

This docket, UM 1282, was opened to investigate the prudence of Avista's gas purchasing strategy for the 2006-2007 gas year. Any party interested in the prudence investigation had the opportunity to intervene, and Avista, NWIGU, CUB, and Staff were the only parties that participated. Another docket, UM 1286, is currently open to investigate the PGA mechanism for Oregon's natural gas utilities. The parties intervening in that case include not only Avista, NWIGU, CUB, and Staff, but also NW Natural and Cascade. It is not unreasonable that NW Natural and Cascade should choose to invest time and effort into an investigation of Oregon's PGA mechanism, while not participating in UM 1282, a specific prudence investigation of another company's gas portfolio for the past year.

To state the obvious, many stakeholders are a party to the general investigation of the PGA mechanism, because changes to the basic mechanism are tantamount to changes in policy. It is entirely appropriate for the Commission to periodically review the PGA mechanism, and invite stakeholders to kick the tires of the mechanism and work through a longer, hopefully collaborative, process to identify improvements and make the PGA and PGA options apply uniformly to all gas companies. It is less appropriate to change the basic PGA mechanism on a company-by-company basis (absent compelling circumstances), thereby making the PGA mechanism less uniform and more atomized. It

is downright silly, however, to do both at the same time – attempting to make policy changes to the PGA on a uniform basis, while simultaneously making individual changes to appease a particular gas company in a particular prudence proceeding.

The Stipulation before the Commission in UM 1282 points out that all parties in this prudence review docket are also parties in UM 1286, but doesn't point out that not all parties in the PGA mechanism investigation are parties to this prudence review.

Stipulation p. 5. Though the Stipulation claims no intent of acting as precedent for UM 1286, any PGA mechanism change authorized by the Commission for one gas utility is likely to be of interest to other Oregon gas utilities. It is not appropriate to revise Avista's PGA mechanism in a docket noticed as a prudence review, as to do so potentially excludes parties who might otherwise have been interested. This is especially true in light of the fact that another docket is currently open to investigate the PGA mechanism as a whole.

B. The Proposed PGA Change Has Not Been Properly Analyzed

The PGA is a complex regulatory mechanism that has been revisited and updated over time in order to improve its functioning and keep it current in a changing industry. This process has involved considerable analysis and debate in order to balance risks and rewards, and to, hopefully, avoid unintended outcomes. In this case, the proposed PGA mechanism change is being recommended without proper analysis and without being vetted by the appropriate parties. Given the central role played by the annual PGA mechanism, it is extremely inadvisable to so casually modify a mechanism that has been carefully developed by a broad range of parties, and that has been functioning reasonably well over time.

Neither the proposed Stipulation with its accompanying testimony nor the Parties' Reply Testimony to CUB's Response demonstrate any serious consideration of the proposed PGA change, the role of the change within the mechanism as a whole, how the proposed change alters the balance of risk between the Company and customers, how the incentives within the PGA mechanism might be altered by the proposed change, or whether the proposed change would serve to further any overarching policy goals of the Commission. Any responsible proposal to alter a utility's PGA mechanism should endeavor to answer all of these questions, and the Stipulation's casual approach to such a change is disconcerting.

In CUB's Response Testimony, we describe one of the ways in which the proposed PGA mechanism change might have unintended consequences.

CUB/100/Brown/7-8. Operating under the proposed PGA modification, if gas prices were to rise, the Company would, when choosing how best to fill its remaining gas needs, be faced with a choice between fixed-price hedges and all other gas procurement options. In this situation, the Company's incentive would be to use hedges exclusively, as customers would bear the entire burden of the rise in price. On the other hand, should prices drop, the Company would be faced with the same choice between procurement options, but the opposite incentive. With lower gas prices, the Company's incentive would be to use all procurement options except hedges, as it would then share 10% of the benefit of the lower prices.

Unfortunately, neither of these situations provide an incentive for the Company to use the best combination of procurement options for the circumstances, and thereby act in the best interest of customers. Under the current PGA mechanism, after its PGA filing,

the Company's incentive, when approaching changing circumstances, would be to use any or all of its procurement options in order to minimize gas costs, as it would share 10% of any post-PGA increase or decrease with customers.

The Parties do not provide support for the incentive structure provided by the PGA change. The Parties give no general policy rationale for the proposed PGA change, and do not explore other possible outcomes from the change. In addition, as pointed out in the previous section, parties with valuable insight that might have been interested are not participating in this prudence review docket. Therefore, the proposed PGA change is being recommended without the benefit of input from those parties.

C. A PGA Mechanism Change Is Not An Appropriate Remedy For Imprudence

Staff requested that the Commission open this docket to investigate the prudence of Avista's gas supply portfolio for the 2006-2007 gas year.

We ... recommend the Commission open an investigation to address whether Avista's natural gas prices are higher than appropriate, given the company's characteristics and gas purchasing options.

Staff Memo to the Public Utility Commission, October 18, 2006, p. 1.

As Staff explains in this memo, Avista had not justified its level of financial hedging for Oregon and the level of hedging for Oregon was far more than what the Company used in procuring gas for its Washington and Idaho service territory. Staff Memo to the Public Utility Commission, October 18, 2006, p. 8. As Avista's prices are too high due to the Company's over-use of financial hedges for its Oregon customers, two appropriate remedies would be financial compensation to customers and steps to avoid such imprudence in the future. Both of these remedies are provided for in the filed Stipulation, which includes a one-time credit of \$500,000 to customers, a discussion of

the Company's procurement strategy for the 2007-2008 gas year, and provisions for Company documentation to clarify the Company's actions and reasoning in the future.

The proposed Stipulation goes too far, however, in modifying Avista's PGA mechanism for the 2007-2008 gas year. The issue of prudence is independent of the regulatory structures under which a Company operates. No regulatory mechanism is perfect, but a utility is expected to operate in a conscientious and judicious manner, regardless. The proposed PGA mechanism change is not an appropriate imprudence remedy, as prudence is independent of regulatory structure.

D. The Proposed PGA Change Would Reduce Avista's Risk

Contrary to the Parties' claim, the proposed change to the Company's PGA mechanism would shift risk and cost from the Company onto customers. This change is being proposed in a vacuum, without any exploration of the balance of risk and reward that is established in the Company's PGA mechanism as it currently stands. In Reply Testimony, the Parties assert:

Q. ... Would the Company be subject to less risk with the additional calculation?

A. No. The additional calculation allows the Company to defer 100% of fixed price hedges completed after the PGA filing, which is the same treatment provided currently for hedges completed prior to the PGA filing.

UM 1282 Parties/100/Zimmerman-Thackston-Pyron/2. Emphasis in original.

The correct answer to the posed question is "yes." The proposed PGA change reduces Avista's risk of gas price increases after its August PGA filing.

CUB/100/Brown/8-10. While it is true that customers pay 100% of hedges completed before the PGA filing, this has not been the treatment that has been used for hedges completed after the PGA filing.

Under Avista's current PGA mechanism, the Company shares 10% of any gas cost variations after its PGA filing with customers, which means the Company is at risk to share 10% of any post-filing price increases. With the proposed PGA change, Avista would not share any post-filing gas cost variations that were captured by a fixed-price hedge. The Company would continue to share 10% of post-filing gas cost variations for gas procured through non-hedge methods. The proposed PGA modification reduces the Company's risk by providing the Company with the option to sign a fixed-price hedge if prices increase, so not share any of that increase with customers.

Under the proposed change, the Company would have the choice, depending upon whether gas prices went up or down, either to share in the benefit or not to share in the burden of any price movement. As described earlier, if gas prices rise, the Company could use fixed-price hedges and not share in the increase, or if prices drop, the Company could use other procurement options and enjoy a 10% share of the benefit. Clearly, this is a reduction in risk compared to the Company's current mechanism.

In supporting the proposed PGA change, the Parties go on to state:

... full recovery of hedged costs is consistent with past Commission PGA authorization.

UM 1282 Parties/100/Zimmerman-Thackston-Pyron/5.

This is not true: the Commission has authorized full recovery of hedged costs before the Company's PGA filing, but after Avista's annual August PGA filing, the Company is expected to share 10% of gas cost variations with customers, regardless of whether the gas is procured through a hedge or any other method. Avista acted imprudently by over-hedging its gas supply portfolio before its August 2006 PGA filing, thereby protecting the Company from the risk of commodity cost changes after its filing.

As the regulatory structure under which Avista currently operates is not as described in the above quote, the Company would like to change its PGA mechanism in order to insulate the Company from post-PGA hedging costs, thereby reducing its risk.

E. Changed Hedging Strategy Is Not A Justification For Proposed PGA Change

Part of the justification the Parties present for the proposed PGA change is that Avista has changed its planned level of fixed-price hedging for the 2007-2008 gas year. Parties/100/Zimmerman-Thackston-Pyron/2. This argument is a red herring. First, of course the Company changed its procurement strategy, since its 2006-2007 strategy was imprudent. Second, we expect a natural gas utility to change its planned level of hedging to react to circumstances as they materialize and to adapt to changing market conditions. This includes modifying its gas purchasing strategy from year to year, or even from day to day, if need be. Avista should change its planned level of hedging in reaction to its situation, not in reaction to its PGA mechanism. The Company's annual hedging strategy should not dictate the Company's annual PGA mechanism.

Also contrary to what is suggested by the Parties' Reply Testimony, the proposed PGA mechanism change is not necessary either to implement the Company's new strategy or to extend the Company's ability to purchase hedges. In Reply Testimony, the Parties argue:

The inclusion of the additional deferral calculation allows Avista to extend its hedging period beyond the PGA filing date and further diversify its natural gas portfolio.

UM 1282 Parties/100/Zimmerman-Thackston-Pyron/5.

It is the Company's responsibility to prudently manage its gas supply portfolio. This is irrespective of whatever regulatory mechanism the Company is operating under.

Avista has a number of tools at its disposal in building its portfolio for Oregon, and one of those tools is fixed-price hedging. The Company is allowed to, indeed expected to, use hedges appropriately in the interest of procuring gas on behalf of customers. Nothing in the current PGA mechanism prohibits the Company from using fixed-price hedges after its PGA filing in August, and, in fact, customers would pay 90% of any post-filing cost variation in the hedge. The PGA mechanism did not force Avista to hedge 90% of its 2006-2007 gas supply for Oregon by its August PGA filing; the Company chose to do that. The proposed PGA change does not change the Company's ability to purchase hedges, and it is not necessary in order for the Company to pursue its current gas procurement strategy.

F. The Commission Is Not Faced With A Hobson's Choice

The Stipulation is intended to resolve the issues of imprudence regarding the Company's over-hedging of its Oregon gas supply. If all the parties cannot agree, then it is the Commission's place to resolve the issues or further direct the parties. It is not the Parties' place to limit the Commission's options.

In our Response Testimony, CUB recommends that the Commission reject the Stipulation as filed, and encourage all the parties to accept a stipulation that does not include a PGA mechanism change. CUB/100/Brown/10. In response to CUB's recommendation, the Parties claim that this is not an acceptable option:

Avista has indicated that it would not agree to the Stipulation if the additional deferral calculation is removed. Avista has noted that it cannot agree to have approximately half of its projected loads exposed to the sharing mechanism in the current volatile natural gas market.

UM 1282 Parties/100/Zimmerman-Thackston-Pyron/3.

That Avista is disinclined to consider a Commission Order requesting removal of the provision modifying the Company's PGA mechanism is not a foundation upon which the Commission can base a decision to accept the filed Stipulation.

Despite the "offer you can't refuse," the Commission can address the filed Stipulation in any number of ways, including the one recommended by CUB. Should the Commission choose not to accept the Stipulation as filed, the Commission's order, reasoning, and recommendations will lay the groundwork for Staff and the intervenors to again work to resolve the issues in this docket.

III. Conclusion

The proposed PGA modification contained in the Parties' Stipulation is not an appropriate remedy for an imprudent gas procurement strategy. Parties who might have been interested in the proposed PGA modification are not participating, as this docket was noticed as a prudence review. In addition, there is currently a docket open specifically to examine the PGA mechanism, and there are parties to that case who have not intervened in this prudence review docket.

The Parties propose the PGA modification without any overarching policy rationale, and without properly exploring the potential implications or outcomes from the mechanistic change. The proposed modification is neither necessary for the Company's 2007-2008 procurement strategy, nor is it necessary to allow the Company to purchase hedges after its PGA filing. Instead, the proposed PGA change would distort the balance of risk and cost sharing in the PGA mechanism, and reduce the Company's risk of sharing price increases after its August PGA filing. The proposed PGA modification

would reward Avista for its imprudent procurement strategy in 2006-2007 by granting the Company a PGA mechanism with risk shifted from the Company to customers.

The Stipulation as filed contains other provisions that adequately address the imprudence of Avista's 2006-2007 gas procurement strategy; specifically, it includes a rate credit to compensate customers, a discussion of the Company's current strategy for 2007-2008, and documentation protocol aimed at clarifying the Company's decisions and actions in the future. We recommend that the Commission reject the Stipulation as filed, and request that all the parties instead consider the Stipulation with the PGA change removed as an appropriate and adequate resolution of Avista's 2006-2007 imprudence.

Respectfully Submitted,
May 1, 2007

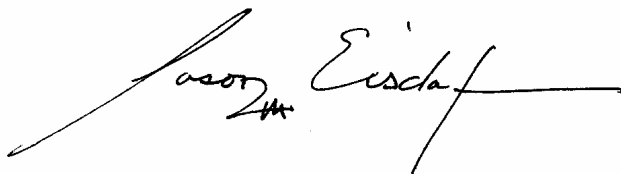
A handwritten signature in black ink, appearing to read "Jason Eisdorfer". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jason Eisdorfer #92292
Attorney for the Citizens' Utility Board of Oregon

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of May, 2007, I served the foregoing Opening Brief of the Citizens' Utility Board of Oregon in docket UM 1282 upon each party listed below, by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,



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W=Waive Paper service, C=Confidential, HC=Highly Confidential

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