ORDER NO. 07-200

ENTERED 05-22-07

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1282

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

DISPOSITION: STIPULATION ADOPTED

On October 25, 2006, the Public Utility Commission of Oregon (Commission) opened an investigation at the request of Commission Staff (Staff). The investigation examined Avista Corp., dba Avista Utilities' (Avista's) options. A stipulation was reached by Avista, Staff, and the Northwest Industrial Gas Users (NWIGU), but it was opposed by the Citizens' Utility Board of Oregon (CUB). For the reasons stated herein, we adopt the Stipulation.

The Commission has adopted purchased gas adjustments (PGAs), in which local distribution companies (LDCs) pass through variations in gas costs to customers through an automatic adjustment clause. In reviewing the appropriate structure of the risk-reward sharing incentive mechanism for gas cost differences, the Commission described the structure of the PGA:

> The PGA has two components. The first component is prospective and resets base gas costs each year to reflect changes in the LDC's cost of purchased gas. These include changes in gas commodity costs and changes in fixed charges not related to the acquisition of the commodity, primarily interstate pipeline demand charges. The second component is retroactive and allows the LDC to defer, for later inclusion in rates: (a) 100 percent of the monthly differences between actual fixed costs and the base level in rates; and (b) a portion of the monthly differences between actual commodity-related costs and the base level in rates. The LDCs accumulate the gas cost differences in a balancing account; the amounts are charged or credited to customers through annual temporary rate adjustments.

Docket UM 903, Order No. 99-272, 1 (footnote omitted). In that case, the Commission adopted a sharing proposal by which the utility would return to customers, through the PGA, 33 percent of any earnings that exceeded the threshold for excessive earnings.[1] *See id.* at 10. In so doing, the Commission declared, "This degree of sharing is significant enough to ensure customers that the LDCs earnings are not excessive, while allowing LDCs to benefit from productive management of the business." *Id.*

In that order, the Commission also addressed the treatment of two types of hedging instruments used to determine the baseline price of gas in the PGA. *See id.* at 13-18. First, the Commission considered fixed price swaps, in which an LDC enters into one contract with a producer to purchase gas at an indexed price and a second contract with a bank to pay a negotiated fixed price; the bank would then agree to pay the indexed price to the producer. The Commission concluded that the swap price should be used to establish the "known and measurable" base gas cost for the upcoming year. *See id.* at 17. Second, the Commission reviewed price caps, also called call options, in which an LDC enters into one contract with a producer to purchase gas at an indexed price and a second agreement with a counterparty to purchase a call option. The call option would set a price cap called the strike price, in which the counterparty would pay the LDC the difference if the indexed price exceeds the strike price. The Commission decided that the cost of caps would be included in the PGA, but the cost of gas would be included at market price, not the strike price. *See id.* at 18. The Commission noted that NW Natural Gas Company submitted evidence that hedging instruments saved customers $3.1 million between 1995 and 1999. *See id.*

Investigation

The Staff report presented at the October 25, 2006, public meeting detailed the reasons for initiating the investigation.[2] Staff report, Item No. 5 & 6 (Pub Mtg Oct 25, 2006). In that report, Staff asserted that Avista did not pursue portfolio purchasing practices that seek diversity, balance, and flexibility in gas supply and instead followed a strategy relying heavily on hedging, at the expense of customers. *See* Staff report, 9. Specifically, Staff compared Avista's hedging strategy to that used by other gas distribution companies in Oregon, and to Avista's hedging strategy in Idaho and Washington. Staff noted that in those states, Avista hedged less than 70 percent of its load requirements and "was able to substantially reduce its gas costs in Washington and Idaho because it was able to purchase additional lower-cost natural gas as prices fell in September," resulting in a small rate increase in Washington and a decrease in Idaho. *See id.* at 10. On the other hand, Avista's hedging strategy in Oregon "is a major factor

[1] Currently, Avista defers 90 percent of the difference between its monthly actual and estimated commodity cost of gas, a sharing structure adopted by the Commission in 2005. *See* Order No. 05-1053, Staff report, Appendix A, 16.

[2] In that report, Staff also recommended that the Commission approve Avista's tariff sheets, to go into effect November 1, 2006, to set the estimated baseline for the automatic adjustment clause, as well as approve the request for authorization to use deferred accounting pursuant to its tariff Schedule 461, the Purchased Gas Cost Adjustment Provision. That recommendation was also approved.

in the higher rates Oregon customers face this year." *Id.* Staff then detailed its documentation of its concerns since 2005 and Avista's responses. Ultimately, Staff asserted that

> [p]rudence of an LDC's purchasing strategy is not dependant on staff or the Commission instructing the utility what to do. Instead prudence should be based on an examination – after the fact and without the benefit of hindsight – of what actions the company took and whether those actions were prudent based on information available at the time. The company is solely responsible for justifying whether its strategy was prudent.

Id. at 15. Staff argued that "the hedging level should be a response to a specific level of assessed operational and supply risk," and not a reaction to the sharing percentage component of the PGA. *See id.* at 15, 17. In addition, Avista completed its hedges before its PGA filing, allowing for 100 percent recovery of those commodity costs, and avoiding the 90/10 sharing mechanism for commodity costs related to hedging incurred after the PGA filing. *See id.* at 10-11.

In response, the Commission opened this investigation into Avista's gas purchasing strategies. A prehearing conference was held on December 8, 2006, establishing a schedule in the docket. NWIGU filed a petition to intervene on December 8, 2006, and CUB filed its notice of intervention on December 12, 2006. A settlement conference was scheduled for January 2007.

Stipulation

On February 9, 2007, a stipulation was submitted by Avista, Staff, and NWIGU; CUB opposed the Stipulation. In section 6 of the Stipulation, Avista agreed to a one-time credit of $500,000 to its PGA 2006-07 sales service customers through the current PGA deferral account. In section 7, Avista committed to a process to keep Staff, NWIGU, and CUB informed on its future hedging strategy; Avista expects that hedging between February through December 2007 will result in no more than 15 percent of the volumes open to fixed price hedging during any 30-day hedge window period. The controversial element is the Stipulation's agreement that prudent, fixed price hedges executed after the date of the final 2007 PGA filing will be passed on 100 percent to customers through the deferral account; other commodity costs will continue to be subject to the 90 percent sharing under the PGA mechanism. Section 8 of the Stipulation details the documentation that Avista will provide to show how it pursued a more prudent portfolio procurement strategy. The signatories agreed that this stipulation should not be used as a precedent for the larger inquiry into PGA design currently underway in docket UM 1286.

Positions of the Parties

CUB opposed the Stipulation in its response testimony, filed March 15, 2007, and brief, filed May 1, 2007. CUB objects to the extent provision allowing Avista to recover 100 percent of all hedging costs for hedges executed after the date of the final 2007 PGA filing, instead of only 90 percent as currently permitted. CUB argues that it does not make sense to modify the PGA while docket UM 1286 is in the process of considering the same issue, and that any modifications should be more thoroughly vetted. Further, CUB adds that some parties involved in docket UM 1286, the docket examining PGA design, should have been notified about the PGA redesign in this docket. This docket was opened exclusively to investigate the prudency of Avista's hedging strategy, according to CUB, and should not expand into changing the design of Avista's PGA, nor is changing the design a proper remedy for Avista's wrongdoing. Finally, CUB objects in principle to this PGA modification, which would allow Avista to recover 100 percent of all hedging costs, as an "ironic twist," in that it "rewards Avista for imprudent actions the Company took in order to avoid risk." CUB/100, Brown/6. CUB rejects any assertion that the PGA redesign will encourage more prudent actions by Avista, noting that the utility already has an obligation to prudently manage its costs.

Signatories to the Stipulation filed reply testimony on March 28, 2007, and also submitted a joint brief on May 1, 2007. These parties support the PGA modification, which will only last one year until the changes set forth in docket UM 1286 are implemented. They argue that this PGA modification will allow for hedges to be spread over a longer period of time, will result in greater diversity, and are in the best interests of customers. As part of the stipulation, Avista will hedge only 70 percent of its load this year, compared to 91 percent last year, resulting in exposure of 30 percent of its load to market conditions. The stipulation also provides that Avista will complete 70 percent of its planned hedges by the PGA filing deadline. Without the extended deferral for hedges, Avista would be exposed to the sharing mechanism for nearly 50 percent of its load (70 percent of load in hedges multiplied by 70 percent of hedges completed by the deadline), instead of 30 percent. Because of the volatile nature of the gas market, Avista has said that it will not agree to the stipulation without extension of the 100 percent deferral allowance to all hedges after the PGA filing deadline.

Analysis and Conclusion

According to Staff's initial report opening this investigation, Avista was completing financial hedges for as much of its Oregon load as it had capacity, and completing those hedges by the time of its PGA filing in order to ensure 100 percent recovery of its costs under the regulatory mechanism in place. This stood in stark contrast to Avista's practice of hedging less than 70 percent of its load in Washington and Idaho, and completing those hedges throughout the year. *See* Staff report, 10. Avista had proposed a maximum hedging level of 80 percent in Washington and Idaho, with three-quarters of that to be completed by the time of Avista's PGA filing in Oregon. *See id.* at 10-11. At the time of Avista's PGA filing in Oregon, it had already completed its hedging of 91 percent of its load in Oregon. *See id.*

In the Stipulation, Avista agreed to cap its financial hedging in Oregon to 70 percent, and to complete its hedges throughout the year, conditioned on it being allowed to recover 100 percent of its hedging costs incurred after the date of the final 2007 PGA filing. This results in Avista's exposure to market conditions for 30 percent of its load, as opposed to the 10 percent exposure prior to the investigation. In contrast, CUB argues that the general structure of the regulatory mechanism should be upheld. If the terms of the current PGA were applied to the presumptively reasonable hedging framework established by the Stipulation, Avista would be exposed to variations in the market for nearly 50 percent of its load. *See* Joint brief, 7-8 (May 1, 2007).

We agree that Avista's increased exposure, from 10 percent of its load to 30 percent, is an incentive for it to prudently manage its gas costs. The alteration to Avista's PGA will last for one year and comports with other provisions of the Stipulation that will make Avista's hedging strategy more transparent and diversified.

We conclude that the Stipulation is a reasonable compromise of the positions of the parties, resolves the problems that arose from Avista's past hedging practices, and provides a framework to ensure more prudent management of gas costs in the future. For these reasons, we find that the Stipulation is in the best interests of customers, and we conclude that the Stipulation should be adopted.

ORDER

IT IS ORDERED that the Stipulation, attached as Appendix A, is adopted.

Made, entered, and effective MAY 2 2 2007.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner

PUBLIC UTILITY COMMISSION OF OREGON

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1282

In the Matter of THE PUBLIC UTILITY COMMISSION OF OREGON An Investigation pursuant to ORS 757.210 and ORS 757.215 to examine Avista Corp., dba Avista Utilities' gas purchasing strategy	STIPULATION RESOLVING ALL ISSUES IN THIS PROCEEDING

This Stipulation is entered into for the purpose of resolving all issues related to the investigation of Avista Utilities' gas purchasing strategies in this docket.

PARTIES

The Parties to this Stipulation are Avista Utilities ("Avista" or the "Company"), the Staff of the Public Utility Commission of Oregon ("Staff"), and the Northwest Industrial Gas Users ("NWIGU") (collectively, "Signing Parties"), but does not include the Citizens' Utility Board ("CUB").

BACKGROUND

1. On October 25, 2006, this Commission commenced an investigation pursuant to ORS 757.210 and ORS 757.215 to examine Avista's gas purchasing strategy.

2. A Prehearing Conference was convened by Adminstrative Law Judge Allen Scott on December 8, 2006, at which time a procedural schedule was adopted and deadlines for intervention established.

3. The Northwest Industrial Gas Users and the Citizens' Utility Board were granted leave to intervene.

4. Pursuant to Judge Scott's Prehearing Conference Memorandum of December 11, 2006, a settlement conference was scheduled for January 4, 2007, at which time all parties to this Docket appeared and participated. The parties reconvened a settlement conference on January 12, 2007, followed by a telephonic settlement conference on January 19, 2007.

5. As a result of the settlement discussions, the Signing Parties have agreed to settle this investigation of Avista's gas purchasing strategy on the following terms, subject to Commission approval.

AGREEMENT

6. One-time credit to customers: Avista agrees to a one-time credit of $500,000 to its PGA 2006-07 sales service customers through the current PGA deferral account as of the date the Stipulation is approved. The Signing Parties agree that this one-time credit does not constitute a precedent in terms of the method by which the credit was derived.

7. The 2007-2008 gas supply portfolio: Regarding the design, preparation, implementation, and assessment of its 2007-2008 gas supply portfolio (the November 1, 2007 through October 31, 2008 delivery period), Avista intends to proceed as follows:

a. By February 12, 2007, Avista will provide to the undersigned Signing Parties, and to CUB, a step-by-step description of its plan for designing, preparing, implementing, and assessing its 2007-2008 gas supply portfolio, including the intended level of fixed-price hedging. This description will also identify and explain any differences between Avista's procurement plan for Oregon and its procurement plan(s) for Washington and Idaho.

b. Avista expects, as of the date of this Stipulation, that any fixed-price hedging will be procured via competitive bidding over the entire period February through

December 2007, with no more than 15% of the volumes open to fixed-price hedging procured during any 30-day hedge window period. Prudent fixed-price hedges executed after the date of the final 2007 PGA filing will be fully passed through the current PGA deferral account, unless Avista chooses to request and the Commission approves a change to the PGA baseline PGA WACOG included in rates. (Appendix A illustrates how this will be accounted for.) Natural gas commodity costs that have not been fixed through hedges will continue to be subject to the 90%/10% sharing under Avista's PGA mechanism. In addition to the fixed-price hedges, Avista will evaluate the use of other products such as options.

c. Avista expects that no counterparty involved in the fixed-price hedges will account for more than 25% of the total annual volumes fixed-price hedging for this period.

d. Avista will monitor market conditions and its system needs, and will modify its gas purchasing strategy as circumstances warrant. Avista will inform and explain these modifications to the Signing Parties as soon as possible, and will offer to provide the same information to CUB.

e. Nothing in these communications is intended to represent or support the prudence of Avista's 2007-2008 gas supply portfolio.

8. Documentation: Avista will document the development and evolution of its gas procurement strategy and resource portfolio, including both physical and financial resources. Avista will monitor fundamental market factors and market-based regional and national price forecasts on a regular basis. Avista will document its research, reasoning, and decisions as it

develops and modifies its gas procurement strategy. Avista will document how interpretations of its system operations/demand and market data and information are made by the Company. Avista will document how it integrates fundamentals data/forecasts and market data for its portfolio development, implementation, and assessment. Relevant regional and national natural gas data and information reviewed by Avista in the preparation and implementation of Avista's gas supply and pricing portfolio will be maintained by the Company for review by Staff and other interested parties.

A. Documentation of Procurement Strategy: Avista will document its procurement strategy and the development of its resource portfolio including:

i. The research and data behind the development of the Company's natural gas procurement strategy and its resource portfolio;

ii. A record of the Company's judgments and decisions made in reaction to the research and data;

iii. A record of the reasoning used to reach these judgments and decisions; and

iv. A detailed record of the portfolio itself, including the resources acquired (financial and physical), transactions, counterparties, bids received, and other relevant information documenting how Avista's procurement strategy and resource portfolio developed over time.

B. Documentation of Each Transaction: By the way of further elaboration of the documentation described in Paragraph 8 of this Stipulation, Avista will document each hedge and deviation from its procurement plan with the following information:

i. Transaction completed or planned transactions that were not completed.

ii. Volumes covered by the transaction.

iii. Synopsis of contract requirements, including time period covered and pricing flexibility.

iv. Form of transaction, e.g, fixed priced physical hedge via storage, fixed priced physical contract, financial swap.

v. Triggering event of each transaction.

vi. Regional and national forward prices as of the time of each decision.

vii. Fundamental forecasts of prices as of the time of each decision.

viii. Other relevant market information.

ix. Bids received by counterparties, including name of counterparty, price of the bid, basin for the transaction, and term of the transaction.

x. Operational factors leading to the basin selection.

xi. Brief narrative explaining reasons for the decision to either hedge or deviate from procurement plan.

Avista will meet with Signing Parties to this Docket, UM 1282, after the first hedging transaction to review the documentation to assure that it meets the needs of the Signing Parties. CUB will also be invited to attend.

9. Relevance of generic PGA review (UM 1286): The Signing Parties to this investigation (UM 1282) understand and agree that there is a separate Docket (UM 1286) that is currently underway to address PGA matters in a more systematic way for all affected natural gas distribution companies, and that all parties to UM 1282 are also parties to UM 1286. In the event this Stipulation, in whole or in part, contradicts a Commission order in UM 1286, the UM 1286 ruling shall take precedence prospectively over this Stipulation. Nothing in this Stipulation is intended to act as precedent for UM 1286.

10. The Signing Parties agree that this Stipulation is in the public interest and results in an overall fair, just and reasonable outcome.

11. The Signing Parties agree that this Stipulation represents a compromise in the positions of the Parties. As such, conduct, statements, and documents disclosed in the negotiation of this Stipulation shall not be admissible as evidence in this or any other proceeding. Further, this Stipulation sets forth the entire agreement between the Signing Parties and supercedes any and all prior communications, understandings, or agreements, oral or written, between the Signing Parties pertaining to the subject matter of this Stipulation.

12. This Stipulation will be offered into the record in this proceeding as evidence pursuant to OAR 860-014-0085. The Signing Parties agree to support this Stipulation throughout this proceeding and any appeal. The Signing Parties further agree to provide witnesses to sponsor the Stipulation at any hearing held, or, in a Signing Party's discretion, to provide a representative at the hearing authorized to respond to the Commission's questions on the Signing Party's position as may be appropriate.

13. If this Stipulation is challenged by any other party to this proceeding, the Signing Parties to this Stipulation reserve the right to cross-examine witnesses and put on such case as they deem appropriate to respond fully to the issues presented, including the right to raise issues that are incorporated in the settlement embodied in this Stipulation. Notwithstanding this reservation of rights, the Signing Parties agree that they will continue to support the Commission's adoption of the terms of this Stipulation.

14. Should the Commission fail to adopt the Stipulation, or should the Commission materially modify the Stipulation, any Signing Party hereto shall have the right to withdraw from the Stipulation and proceed with a resolution of all issues in this proceeding.

15. By entering into this Stipulation, no Signing Party shall be deemed to have approved, admitted, or consented to the facts, principles, methods, or theories employed by any other Signing Party in arriving at the terms of this Stipulation. No Signing Party shall be deemed to have agreed that any provision of this Stipulation is appropriate for resolving the issues in any other proceeding.

16. This Stipulation may be executed in counterparts and each signed counterpart shall constitute an original document. The Signing Parties further agree that any facsimile copy of a Signing Party's signature is valid and binding to the same extent as an original signature.

17. This Stipulation may not be modified or amended except by written agreement among all Signing Parties who have executed it.

This Stipulation is entered into by each Signing Party on the date entered below such Party's signature.

DATED this 8th day of February, 2007.

AVISTA CORPORATION

By: ______________________________

Date: ______________________________

STAFF OF THE PUBLIC UTILITY COMMISSION OF OREGON

By: ______________________________

Date: ______________________________

NORTHWEST INDUSTRIAL GAS USERS

By: ______________________________

Date: ______________________________

DATED this 8th day of February, 2007.

AVISTA CORPORATION

By: ______________________________

Date: ______________________________

STAFF OF THE PUBLIC UTILITY
COMMISSION OF OREGON

By: [illegible signature]

Date: Feb 8, 2007

NORTHWEST INDUSTRIAL GAS USERS

By: ______________________________

Date: ______________________________

DATED this ____ day of February, 2007.

AVISTA CORPORATION

By: ______________________________

Date: ______________________________

STAFF OF THE PUBLIC UTILITY COMMISSION OF OREGON

By: ______________________________

Date: ______________________________

NORTHWEST INDUSTRIAL GAS USERS

By: Paula E. Pyron

Date: February 8, 2007

APPENDIX A

Additional Adjustment for Post-PGA Hedged Volumes

(A) Delivery Period	(B) Remaining Hedged Volumes (Established in procurement plan and detailed in PGA filing)	(C) Actual Hedged Price on Remaining Hedged Volumes (Documented and provided to Staff)	(D) PGA Spot Price for Each Month (Detailed in PGA filing)	(E) Difference Between Actual Hedge Price and Price in PGA Filing	(F) Total Value of Difference	(G) 10% of Difference - Adjustment to Deferral Balance (Negative value reduces deferral balance, positive balance increases deferral balance)
				(C) - (D)	(B) * (E)	(F) * 0.10
Nov-07		$ -	$ -	$ -	$ -	$ -
Dec-07		$ -	$ -	$ -	$ -	$ -
Jan-08		$ -	$ -	$ -	$ -	$ -
Feb-08		$ -	$ -	$ -	$ -	$ -
Mar-08		$ -	$ -	$ -	$ -	$ -
Apr-08		$ -	$ -	$ -	$ -	$ -
May-08		$ -	$ -	$ -	$ -	$ -
Jun-08		$ -	$ -	$ -	$ -	$ -
Jul-08		$ -	$ -	$ -	$ -	$ -
Aug-08		$ -	$ -	$ -	$ -	$ -
Sep-08		$ -	$ -	$ -	$ -	$ -
Oct-08		$ -	$ -	$ -	$ -	$ -