ORDER NO. 07-477

ENTERED 10/30/07

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 180/UM 1346

In the Matters of AVISTA CORP., dba AVISTA UTILITIES Avista's Oregon Natural Gas Sales Customers/Schedules: First Revision Sheet 495, Canceling Original Sheet 495 - Glendale Surcharge. (UG 180) and Application for Authorization to Utilize Deferral Accounting for the Difference Between the Actual Revenue Collected From Customers Under the Proposed Glendale Surcharge Rate Schedule 495 and the Estimated Monthly Amounts Filed in Advice No. 07-08-G. (UM 1346)	)	ORDER

DISPOSITION: APPLICATIONS APPROVED

On September 25, 2007, the Public Utility Commission of Oregon (Commission) received two applications from Avista Corp., dba Avista Utilities (Avista Utilities). A description of the filings and their procedural history is contained in the Staff Report, attached as Appendix A, and incorporated by reference.

Based on a review of the applications and the Commission's records, the Commission finds that the applications satisfy applicable statutes and administrative rules. At its Public Meeting on October 30, 2007, the Commission adopted Staff's recommendation to approve the applications as set forth in the Staff Report.

ORDER

IT IS ORDERED that:

1. The stipulation in docket UG 180 related to proposed ratemaking treatment is adopted.

2. Schedule 495 in docket UG 180 is allowed to go into effect on November 1, 2007.

3. The request to establish a deferral account, as filed in docket UM 1346, is authorized.

Made, entered, and effective OCT 30 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.

ITEM NO. 3, 4, 5, 6

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: October 30, 2007

REGULAR X **CONSENT** ____ **EFFECTIVE DATE** November 1, 2007

DATE: October 23, 2007

TO: Public Utility Commission

FROM: Ken Zimmerman, Lynn Kittilson, Carla Owings and Deborah Garcia

THROUGH: Lee Sparling, Ed Busch, Bonnie Tatom and Judy Johnson

SUBJECT: AVISTA UTILITIES: (Docket No. UG 178/Advice No. 07-07-G) Reflects changes in the cost of purchased gas and technical adjustments.

(Docket No. UM 1341) Requests reauthorization of the PGA deferral mechanism.

(Docket No. UG 180/Advice 07-08-G) Requests modification of Schedule 495 and associated stipulation regarding ratemaking treatment for the conversion of the Glendale propane system to natural gas.

(Docket No. UM 1346) Requests authorization to defer the difference between actual revenue collected and rates imposed by Schedule 495 for costs incurred to convert the town of Glendale from propane to natural gas service.

STAFF RECOMMENDATION:

Staff recommends the Commission approve Avista Utilities' (Avista or Company) request for authorization to use deferred accounting pursuant to its tariff Schedule 461, Purchased Gas Cost Adjustment Provision; and waive statutory notice (L.S.N.) and allow the Company's proposed tariff sheets in Advice No. 07-07-G Supplemental to become effective with service on and after November 1, 2007. This filing decreases the Company's annual revenues by approximately $2.23 million, or 1.70%.

Staff further recommends the Commission approve the Company's request to establish a deferral account to enable the accounting requirements found in Schedule 495 (UM 1346); adopt the associated stipulation; and the changes to Schedule 495 as filed in Advice No. 07-08-G (UG 180).

Avista Utilities 2007 PGA Filing
October 23, 2007
Page 2

DISCUSSION:

On September 4, 2007, Avista filed its annual gas cost tracking and technical adjustment application, commonly known as its PGA filing. The PGA allows Avista to adjust tariffs annually for known and measurable changes in purchased base gas costs and for changes in amortization rates relating to the PGA account and other deferred accounts. The filing, docketed as UG 178, proposed a revenue decrease of approximately $774,000, or 0.58%, effective November 1, 2007. This filing reflects the changes in the cost of purchased gas and amortization of deferred revenue, gas cost and non-gas cost accounts through the temporary increment adjustment. In a concurrent filing docketed as UM 1341, Avista requested reauthorization of deferrals under the Company's PGA mechanism.

On October 12, 2007, the Company replaced Advice No. 07-07-G in its entirety and filed replacement Advice No. 07-07-G Supplemental, along with an L.S.N. application, to lower its projected commodity cost. The re-filed PGA requests an overall revenue decrease of approximately $2.23 million annually, or 1.70%.

UG 178

In its amended filing, Avista seeks approval for an overall 1.70% rate decrease to its Oregon customers. This rate change consists of a decrease in the base cost of the Company's system gas supplies and an increase from adjusting the amortization rates for deferred revenue and gas cost accounts. The total change in annual revenues is summarized in Table 1 and is shown in Attachment A.

Table 1: Change in Annual Revenues

PGA Base Gas Cost Change	($7,473,039)
Removal of Temporary Increment	($5,797,365)
Adding New Temporary Increment	$11,039,462
Total Proposed Decrease	($2,230,943)[1]

With these changes, the monthly bill of a typical residential customer using 51 therms per month will decrease by $1.02, or 1.3%, from $78.91 to $77.89. In January, a typical residential customer's consumption of 98 therms would result in a billing decrease from $147.03 to $145.06.[2]

[1] Column does not add correctly due to rounding in the Company's exhibit.
[2] The monthly bill changes also include the effects of the Company's Schedule 495, Glendale Surcharge – Oregon (see pages 14-16 for a complete discussion of this surcharge).

A summary of the proposed tariff and revenue changes for Avista's major rate schedules, exclusive of the Schedule 495 surcharge is shown in Attachment A. A summary that compares the impact of this year's proposed PGA rate changes, on both an annual and a January basis, for Avista, Cascade and Northwest Natural residential customers is shown in Attachment B. For Avista, the rate includes the Glendale surcharge which is proposed to go into effect on November 1, 2007. A graph illustrating each of the three local distribution companies' (LDCs') effective residential rates on a comparable basis is found in Attachment C. The effective residential rate is calculated as follows: the proposed residential rate multiplied by 56 therms plus the monthly customer charge, divided by 56 therms. The graph shows that Avista's residential customers have an effective rate of $1.51843 per therm, while Cascade's and NW Natural's effective rates are $1.26241 and $1.33163, respectively. Table 2 shows the rates the Commission has approved for Avista's residential customers on Rate Schedule 410 between 2003 and 2006, and the current proposal.

Table 2: Residential Rates 2003 – 2007 (Proposed)

Date	Customer Charge	Rate Per Therm	Percentage Change [3]
October 2003	$5.00	$0.88787	
April 2004	$5.00	$0.95764	7.9%
October 2004	$5.00	$1.08689	13.5%
October 2005	$5.00	$1.34729	24.0%
November 2006	$5.00	$1.44931	7.6%
November 2007 (Proposed)	$5.00	$1.42914	-1.4%

Avista offers customer assistance programs. Avista also offers energy efficiency programs through the utility and through Energy Trust of Oregon. Specific information on these programs is readily available to customers on their monthly bills, by telephone, in person at the Company offices, and on the Company's web site.

National and Regional Natural Gas Markets

In terms of natural gas prices and natural gas price volatility, 2006 and thus far in 2007 have been quiet.

[3] The percentage change reflects only the change in the rate per therm, and does not include the effect of the monthly customer charge on the bill. In 2007, when the rate per therm is combined with the monthly customer charge of $5.00, the average customer's bill is decreased about 1.3%, as shown on Attachment B.

- The winter of 2006-2007 was generally mild; no great demand was placed on existing natural gas supply;
- The summer of 2007 was mild in terms of the use of natural gas to generate electricity to meet cooling demand;
- No major supply interruptions have occurred to date; the hurricane season has been mild and uneventful;
- The prices of natural gas and oil have generally de-linked—rising oil prices are not currently carrying natural gas price along;
- Gas storage injections and inventory levels are at historic highs;
- The futures markets, including speculators and hedge funds traders, have generally not been able to promote any sustained increase in natural gas prices; futures prices across the country have consistently and generally declined, with particularly sharp declines in the West (e.g., Rockies);
- Domestic supply has remained steady, with no substantial decline—the number of wells being drilled for domestic natural gas has increased about 300%, helping domestic supply remain steady or even increase slightly;
- Liquefied natural gas (LNG) imports, while not growing, remain poised to increase over the next several years; and
- The development of unconventional natural gas sources (e.g., coalbed methane, tight sands, deep-water) has expanded with significant events on both the technical and financial fronts.

Of course, other potential factors may lead to increases in the price of natural gas. LNG imports into the US, while expanding, are not increasing at the rate expected. Plus, many other countries in the world are bidding for LNG supplies to help kindle their economic growth. Biggest among these are Japan, Korea, and several countries in Europe. Second, imports of natural gas from Russia to Europe, China, etc., are not growing as quickly as expected, and it appears that Russia (the single largest holder of natural gas reserves in the world) is increasingly using natural gas and oil as foreign policy tools to seek control of the actions of other nations. Third, weather can play a large part in increasing natural gas price. For example, an up tick in the severity or length of the US hurricane season or an exceptionally cold winter in either the US or Europe could lead to significant increases in prices. Fourth, any large increase in either industrial production or the use of natural gas for electric generation could potentially lead to increases in the price of the resource. Fifth, any failure in the expected level or growth in the level of domestic natural gas production, either conventional or unconventional, could lead to an increase in price. Sixth, imports of natural gas from Canada have declined since at least 2004 and declined by about two-thirds since 2005. Finally, the futures markets for natural gas, particularly the hedge funds involved in those markets, dominate both that market and the physical natural gas market in terms of money invested. With those futures markets not currently functioning in accordance with even the most expansive understanding of "market theory," the impacts of these markets on future natural gas prices cannot be understood and thus are difficult to accurately forecast. On this front there is some good news. Both the Federal Energy Regulatory Commission (FERC) and the Commodity Futures Trading Commission (CFTC) have recently opened "market manipulation" cases on one of the largest energy hedge funds, Amaranth. There is a jurisdictional dispute the courts will need to settle before either FERC or the CFTC can go forward on these cases. After that, Staff will know more about whether the FERC or CFTC, or the two together, can reign in these massive energy hedge funds.

The US Department of Energy's (DOE) Energy Information Administration (EIA) weekly natural gas update shows the history of natural gas prices on NYMEX and physically at the Henry Hub, as well as the price of West Texas Intermediate (WTI) crude oil. Figures 1 and 2 are snapshots from those numbers for the period November 2006 to September 2007. The pattern for natural gas prices is steady or declining since early in 2007, both at NYMEX and physically at Henry Hub. Since June, prices have noticeably declined. Also, these prices are overall notably lower than the prices in 2006. Figure 1 demonstrates clearly that oil and natural gas prices have de-linked. In Figure 2 (see top of next page), estimated prices for the Northwest Pacific (NWP) winter and PGA year futures strips are also depicted. Unlike the pattern for prices in the current futures months, both winter and PGA-year strips declined until July, shot up by over a dollar during August, and then declined almost a dollar in September.

Figure 1: Natural Gas and WTI Prices, Nov 2006 – Sep 2007

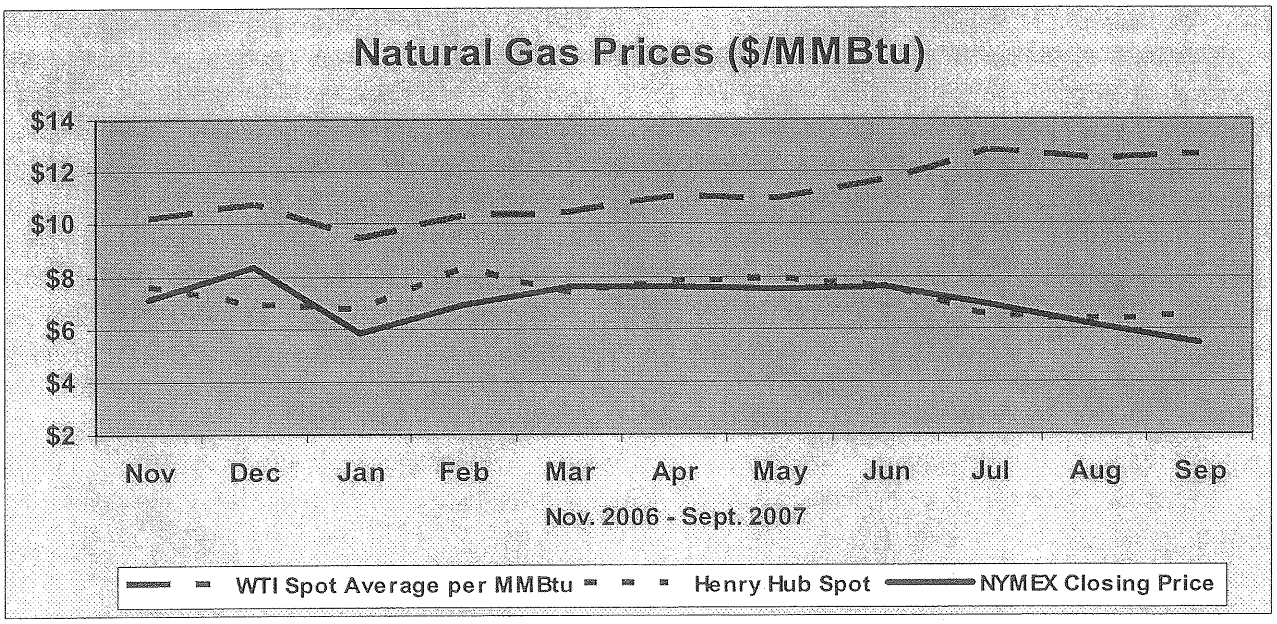
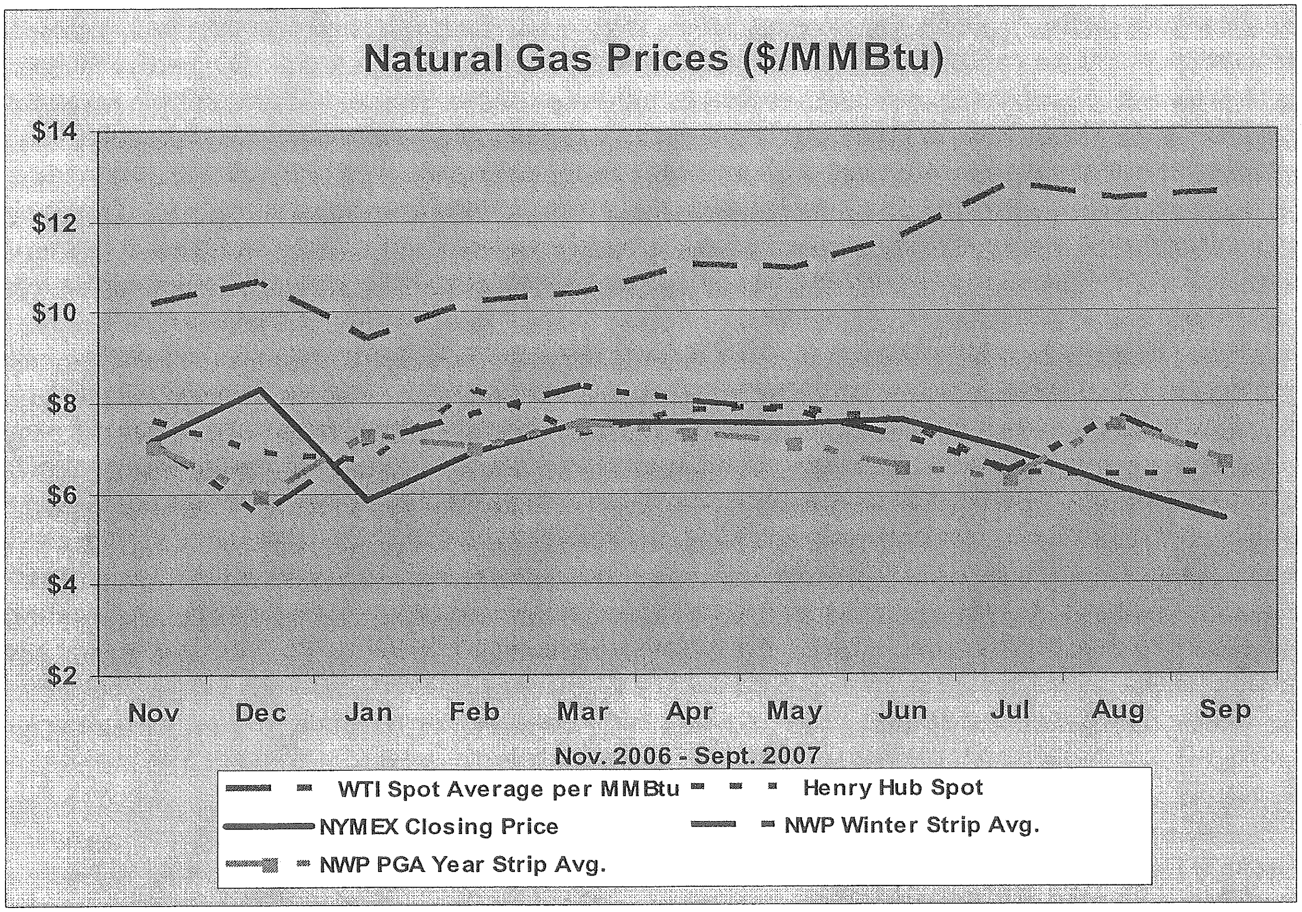


Figure 2: Natural Gas (National and NWP) and WTI Prices, Nov 2006 – Sep 2007



The EIA forecast of the natural gas price at the Henry Hub has fluctuated since January within a generally narrow range. The next 12-months EIA forecast began the year at $7.06/MMBtu. In its August 7, 2007 forecast, the EIA projected an average Henry Hub price for 2007 of $7.45/MMBtu; for the next 12-months beginning August 2007 at the Henry Hub of $7.66/MMBtu; and projected an average price for the winter season at the Henry Hub of $8.27/MMBtu. These forecasts and actual prices translate to natural gas prices, for the hubs from which Oregon LDCs purchase, of about $7.00/MMBtu for the PGA year and about $7.50/MMBtu for the winter season. Of course, all Oregon LDCs "lock-in" the price of a portion of their natural gas supply portfolio well in advance of the 2007-2008 winter season, including multi-year fixed price financial contracts, and place natural gas into storage during the off-peak season for withdrawal during the winter season. This means the overall pricing for their portfolios cannot, and properly should not, reflect only current natural gas prices and price forecasts.

Barring disturbing factors (e.g., severe hurricane damaging a large portion of Gulf Coast production, colder than expected winter), the current pattern of falling and low-volatility pricing is likely to continue at least through the winter of 2007-2008.

Natural Gas Purchasing Strategies

Staff continues to emphasize that "portfolio purchasing" has been accepted for the last two decades as the best means to deal with the risks involved in the purchasing of natural gas by LDCs. This purchasing approach requires that LDCs focus on selecting portfolios of gas supplies based on their overall risk-reward characteristics instead of merely compiling portfolios of purchases that each individually has attractive risk-reward characteristics. In a nutshell, LDCs in purchasing natural gas should select portfolios not individual supply options. Such a portfolio should display the three characteristics of balance, flexibility, and diversity, and should be based on the particular circumstances in which the purchases are made. The greater the risks of price change or supply availability, the greater the need to follow the diversity requirements of portfolio theory.

Staff emphasizes the following points about portfolio purchasing that should be applied by all three LDCs. These points have been reviewed in meetings with the LDCs throughout the past three years and were included in last year's PGA Staff Reports.

1. In specific practice, portfolio purchasing means the LDC must purchase a combination of resources, including demand-side options, to meet the needs of its customers that are balanced, diverse, and flexible. Thus it is not just the size of each resource making up the portfolio that must meet these objectives but also such elements of the portfolio as timing, duration of supply contract, location of supply, contracting form/type, pricing, etc.

2. While the current natural gas market arrangements do limit the options of LDCs in controlling the level and volatility of the price paid for natural gas, portfolio purchasing provides an array of tools to retain at least some LDC control over these pricing concerns.

3. Overemphasizing any particular resource option(s) in a portfolio is contrary to the proper application of portfolio purchasing, no matter the precise form of that overemphasis or the resource(s) to which it is applied. In 2005, all the Oregon LDCs entered into financial hedging arrangements for too large a share of their natural gas supply. Some, but not all, the LDCs also made this mistake in 2006. Avista has not made that mistake in the current PGA filing.

4. Purchasing natural gas via the portfolio approach requires more attention and effort by the LDC to gather, review, interpret, and apply market intelligence in constructing the portfolio; in monitoring the actual functioning of the portfolio constructed; and in modifying the portfolio as market or operational changes require. This is hard work, especially when compared to purchasing natural gas from daily, weekly, or monthly cash markets.

5. There is no "one size fits all" in portfolio construction. Each portfolio must be designed, constructed, applied, and reviewed based on existing and expected market conditions and on the demand, supply, operational, and general economic circumstances of the LDC for whom the portfolio is being constructed.

6. Each and every portfolio decision and action must be as fully documented as possible. That is, the details behind every decision and action in making a portfolio choice must be available for review and analysis by the LDC and Staff without any extraordinary effort on the part of either the LDC or Staff.

Avista's Natural Gas Purchasing Strategies

In its review of Avista's 2006 PGA, Staff indicated it had multiple concerns regarding Avista's gas purchasing strategy, particularly the Company's decision to financially hedge over 90% of its volumes prior to the PGA year. To address those concerns Staff asked the Commission to open docket UM 1282. That docket was completed with a negotiated settlement that addressed all of Staff's concerns. The settlement stipulation was approved by the Commission in Order No. 07-200, issued on May 22, 2007. Staff has been working with Avista to effectively implement the terms of the stipulation. The results have been very satisfactory. Paragraphs 7 and 8 of the stipulation address the changes agreed to in Avista's gas supply portfolio and documentation.

In its 2006 PGA portfolio, Avista had financially fixed the price for about 91% of its expected annual sales and expected to provide from storage only about 1% of the volumes its customers required. That picture has changed this year, as shown in Table 3 below. Staff supports the changes.

Table 3: Avista Gas Supply Portfolio

Resource	Percentage in Portfolio
Pipeline deliveries of natural gas	95.60%
Storage deliveries of natural gas	4.40%
Percentage of firm natural gas deliveries fixed via financial hedges	61.26%

Avista plans to financially fix the price of additional volumes subsequent to the PGA filing, but its target for financial hedging is approximately 70% of expected annual sales, as it had stipulated to in UM 1282. With regard to storage, Avista has purchased and will begin to utilize for its 2008 PGA even more storage than included in this year's portfolio. This additional storage for 2008 will bring total storage deliveries to nearly 7% of Avista's portfolio. This further addition to storage deliveries for next year is reasonable.

Avista's hedging program is still not functioning as it should, however. Avista's overall hedge price is approximately \$8.05/Dth, which stands above the highest level of the range Staff can support as reasonable for futures pricing (see Table 4). Also, Avista's hedging price is well out of line with those of NW Natural (\$7.36/Dth) and Cascade (\$7.66/Dth). On the other side of the equation, however, Avista has discussed with Staff each hedge entered to date. The prices available at each of the times Avista actually entered a hedge appeared reasonable; almost all fell below the 70% threshold Staff and Avista were employing to test the reasonableness of prices during each one-month hedging period. So the fault here seems to be either in Avista's hedging schedule or with the particular counterparties with whom Avista enters hedges. Staff and Avista continue to work on this dilemma and hope to find a resolution in the coming months.

Table 4: Staff's Hedging Price Range for 2007 PGAs[4]

High	Low
\$7.80	\$7.38

Overall, the Company has secured a reasonable portfolio for an LDC of Avista's size, operational characteristics, and market options. In addition, Avista's entire gas procurement process and planning are much improved. It is generally well organized, monitoring available market, demand, weather, and other information on a regular and comprehensive basis, maintaining and providing to Staff and other parties reasonable documentation of its decision making processes, and working harder to understand which options at which times work best for Avista and its customers. Avista's hedging process remains a bit too mechanical, but even that has begun to change, with Avista testing moving away from automatically executing financial hedges based solely on prearranged time and price benchmarks.

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[4] This range is based on a weighted average made up of high and low prices for the winter and PGA year Northwest Pacific winter strips combined with the averages for these strips over the period November 2006 to September 2007.

Overall, Avista is doing well in achieving portfolio purchasing practices for its gas supply. In particular, Avista seems to be making reasonable progress in implementing purchasing optionality; portfolio diversification, flexibility, and balance; competitive bidding; mathematical testing of supply portfolios; and better coordination of supply-side and demand-side resources for meeting demand. Staff expects this progress to continue and considers the regular quarterly meetings with Avista a critical element in this continued progress.

Avista's Natural Gas Costs

For the time during which Avista purchased gas for the period November 2007 through October 2008, the average cash (spot) price in the Northwest was approximately $6.00/MMBtu, with prices relatively stable until the most recent three months, June, July, and August, when prices declined noticeably. The NYMEX price over the period November 2006 to August 2007 averaged about $8.25/MMBtu for the PGA year and about $8.60/MMBtu for the winter period, with a similar price pattern. Over that same period the average forward prices for the hubs at which the Oregon LDCs purchase were about $6.95/MMBtu for the PGA year and about $7.30/MMBtu for the winter period, also with a similar price pattern.

At the end of June 2006, both interstate pipelines Avista transports on filed general rate cases at FERC. Northwest Pipeline (NWPL) requested a rate increase of about $119 million, mostly related to rate base additions and an increase in its rate of return. Gas Transmission Northwest's (GTN) filing requested nearly double its current rate for firm transportation. The LDCs and Staff agreed to place the full rate increase requested by both pipelines into the filed 2006 PGAs, subject to refund based on the actual rates finally approved by the FERC. A settlement was reached in the NWPL case in February 2007 and in the GTN case in September 2007. Both settlements set rates lower than those requested by the pipelines, which had been put into place in January 2007 subject to refund. Avista has incorporated into its PGA filing the rates agreed to in the settlements. Any differences between these settlement rates and final rates will be addressed through the deferral accounts. Avista will pass through refunds from NWPL and GTN when those are made by the pipelines.

The commodity price and transportation demand charge Avista proposes to pass through to its sales customers are shown in Table 5 (see top of next page), along with the range of prices for commodity Staff recommends as reasonable. Staff accepts the demand charge proposed by Avista, as it is established via FERC tariff. However, as explained below, Staff has made certain that the actual demand charges in effect for the upcoming year are being proposed for pass-through by Avista.

Table 5: Avista Commodity and Demand Costs for 2007 PGA[5]

Charge ($/therm)	Avista	Staff's Range
Commodity	$0.76414	$0.70000 - $0.80000
Commodity (revenue sensitized)	$0.78620	$0.72021 - $0.82309
Demand	$0.22018	$0.22018
Demand (revenue sensitized)	$0.22654	$0.22654
Total	$0.98432	$0.92018 - $1.02018
Total (revenue sensitized)	$1.01274	$0.94674 - $1.04963

Obviously, Avista's proposed gas costs are above the midpoint of Staff's range of charges. However, Avista's gas costs are reductions from those currently in place for the Company. The proposed commodity weighted average cost of gas (WACOG) is a 10.86% percent reduction. The total gas cost (with transportation charges) is an 8.21% reduction. The commodity charge reduction is offset in part by an increase in transportation demand charges. This offset was diminished by the new negotiated NWPL and GTN rates included in the Company's filing. Avista, along with the other LDCs, agreed to compute its 2007 PGA demand costs to capture these lower rates.

As indicated by Avista in the re-filing of its 2007 PGA, Staff brought to the Company's attention a not inconsequential concern that the Company's forecast of spot/short-term prices for the coming PGA year is based solely on a 60-day forwards strip, with no consideration of forecasts based on analysis of fundamental market variables. Avista has access to several such "fundamentals" forecasts but in its original filing gave them no weight in arriving at the Company's forecast of future spot/short-term (cash) prices for natural gas. That forecast could be applied to up to as much as 38.74% of Avista's total gas requirements. Staff proposed to Avista that it amend this forecast to include at least two "fundamentals" forecasts from those to which the Company has current access. Staff's rationale for this request was simple, quite clear, and consistent with long accepted forecasting methodology. Moreover, in Staff's view it is each LDC's responsibility to incorporate (mathematically if possible) both market intelligence and

[5] The low value in Staff's range is a 60%/20%/20% weighted average of the median values for the NWP futures strips for the winter and PGA year over the period November 2006 to September 2007 in combination with the average of six selected fundamentals forecasts. The high value in Staff's range is a 60%/20%/20% weighted average of the highest values for the NWP futures strips for the winter and PGA year over the period November 2006 to September 2007 in combination with the average of six selected fundamentals forecasts. Both values are rounded to the nearing whole dollar.

fundamentals forecasting data in arriving at the LDC's projection for future spot/short-term natural gas prices at the various points from which purchases are made.

In its re-filing, Avista has come part way in addressing Staff's concern. The Company's decision to revise its forecast for spot/short-term natural gas prices based on a mix of historical forward prices (75%) and the most recent fundamentals forecast produced by Wood-Mackenzie (25%) is a positive step and is appreciated. Wood-Mackenzie is a respected company, and its fundamentals forecasts of natural gas prices are widely utilized. Staff remains concerned, however, that Avista continues to rely much too heavily on a single set of numbers, forward market prices, and needs to diversify further the sources used to produce its PGA forecast for spot/short-term natural gas prices. Diversification of sources is the only way to ensure that these forecasts are reasonable and do not place additional risk on LDC customers and shareholders. But Staff agrees with Avista that UM 1286 is the proper forum for discussing and resolving this issue. Consequently, Staff recommends acceptance by the Commission of Avista's partial solution for the 2007 PGA, until a final resolution is reached in UM 1286. If, however, this final resolution is not reached in time for the 2008 PGA filing by Avista, Staff intends to again bring this issue to the attention of Avista and to seek greater natural gas price forecasting source diversity for the Company's 2008 PGA portfolio.

For several reasons Staff considers Avista's gas costs shown in Table 5 reasonable and prudent. First, they are within the price range established as reasonable by Staff, albeit at the higher end of that range. Second, the flow-through of lower NWPL and GTN transportation charges has reduced the demand costs somewhat. Finally, Avista has adhered to all the elements of the stipulation it agreed to in UM 1282, and in absolute terms Avista's gas purchasing and planning and portfolio design are improving and the Company can reasonably be expected to continue that improvement.

Staff recommends the PGA gas costs proposed by Avista be allowed to go into effect on November 1, 2007. The overall decrease in revenues proposed by Avista is $7,473,039.

Technical Adjustments – Deferred Accounts

Staff has reviewed the deferred accounts and verified the accuracy of the amortization rates, the accuracy of the costs posted to the accounts, the interest rates applied to the accounts and the calculation of lost margins. Over the past twelve months, Staff has worked closely with Avista to improve the models used by the Company to make these calculations as well as the reporting format and documentation needed by Staff to review the accuracy of these accounts.

Most of the Company's proposed decrease in the commodity cost is offset by the proposed increase in the amortization rate for Residential Service Schedule 410 and General Service Schedule 420. The difference in the total amortization rate increase for the Schedule 410 and 420 customers as compared to Large General and Industrial Service Schedule 424 and Seasonal Service Schedule 444 is caused by the implementation of an amortization rate of $0.03494 to recover the balance in the "Margin Reduction Account" (Account). This Account was established to defer the monthly revenue reduction resulting from rate decreases to Interruptible Sales Schedule 440 and Transportation Service Schedule 456. These rate decreases, and recording of associated deferred revenue, were part of a stipulation approved by the Commission in Order 03-570. Pursuant to the stipulation, Avista was not allowed to recover the Account balance until the Company's first rate reduction. This filing represents the first rate reduction since the adoption of the stipulation. The stipulation further states that the deferred balance is to be recovered from Schedule 410 and 420 customers over a 12-month period, beginning simultaneously with the PGA rate change, so long as such recovery does not result in a PGA increase to those customers. In compliance with that stipulation, Avista proposes to implement a surcharge on Schedule 496 of $0.03494 for Schedule 410 and 420 customers to recover the deferral balance of approximately $2.6 million over a 12-month period beginning November 1, 2007. Absent this surcharge, the PGA rate decrease for the Schedule 410 and 420 customers would have been approximately 4%.

For Avista's other deferral accounts (commodity, demand and DSM), the filing includes a proposed increase of approximately 2.9 cents per therm to all firm sales schedules. This proposed increase is designed to recover all current deferral balances (excluding certain DSM accounts) by October 31, 2008. Staff agrees with Avista's proposal to recover these costs over a 12-month period and recommends the Commission approve the Company's request.

Earnings Review and Three Percent Test

Until 1999, as a matter of policy, the Commission conducted earnings reviews for both prospective purchased gas cost changes and PGA-related deferrals. The Commission then adopted OAR 860-022-0070, which requires an annual spring earnings review in lieu of an earnings review related to prospective purchased gas cost changes. In 2005, Staff and Avista agreed upon a sharing mechanism of 90/10. As the Company's level is less than the 33 percent sharing prescribed under OAR 860-022-0070(8), the Company is also subject to a fall earnings review, as well as the mandated spring earnings review. The purpose of the fall earnings review is to determine whether or not Avista should absorb any of its gas cost deferrals. Based on the results of the Company's most recent results of operations report, Avista's regulatory-adjusted return on equity for 2006 was 5.80 percent, well below the Commission-authorized 10.25 percent. Therefore, Staff concludes that the Company could not absorb any of the deferrals and earn a reasonable rate of return.

ORS 757.259 (6) and (7) states that the overall annual average rate impact of the amortizations authorized under the statute may not exceed three percent of the natural gas utility's gross revenues for the preceding calendar year, unless the Commission finds that allowing a higher amortization rate is reasonable under the circumstances. The amortization rate to recover the total deferred balances proposed by Avista in a twelve-month period exceeds the 3% gross revenues from the prior year. Staff has analyzed other options with the Company and the customer groups. However, the Company believes, and Staff agrees, that the opportunity to amortize the existing deferral balances to a much lower level benefits the ratepayers in the future by minimizing the potential for rate increases in future years. Staff finds that the rate increase is just and reasonable and recommends the Commission adopt the increase pursuant to ORS 757.259 (7).

UM 1341

In this filing, Avista requests reauthorization of deferrals pursuant to its automatic adjustment clause, the PGA mechanism. The PGA allows the Company to adjust tariffs annually for known and measurable changes in purchased base gas costs and for changes in amortization rates relating to the PGA balancing account. The Company also requested reauthorization of its deferral accounting for the reduction in margin for interruptible and transportation customers as set forth in Commission Order No. 03-570.

Avista's application states that continued deferral of these cost and revenue differences minimizes the frequency of rate changes and appropriately matches costs borne and benefits received by ratepayers, consistent with ORS 757.259(2)(e). The reasons cited for reauthorization are still valid. Staff recommends the Commission approve the request for reauthorization to use deferred accounting pursuant to tariff Schedule 461, effective November 1, 2007.

**Glendale System Conversion from Propane to Natural Gas
Docket UG 180 (Advice No. 07-08-G) and Docket UM 1346**

Avista is requesting Commission adoption of the following three items associated with the ratemaking treatment for the conversion of the Glendale propane system to natural gas:

1. A stipulation signed by Avista, Citizens' Utility Board, Northwest Industrial Gas Users, and Staff (Parties) agreeing to the terms of the proposed ratemaking treatment;

2. Schedule 495 Glendale Surcharge – Oregon, a request to modify the current rate; and
3. A deferral account to enable the accounting treatment required by Schedule 495.

The background for these requests, including a copy of the stipulation, was first presented to the Commission at its April 24 public meeting[6] in conjunction with Avista's request that the Commission approve Schedule 495 Glendale Surcharge - Oregon with an effective date of November 1, 2007. Staff requested that Avista file this "placeholder" tariff well in advance of the 2007 PGA filing date due to the complexity of PGA filings and the relatively short review time before the new rates go into effect. The request was supported by Staff and approved by the Commission with the understanding that Avista would file a replacement tariff coincident with this PGA filing to update the rate based on updated gas purchase estimates, and also request Commission adoption of the stipulation.

<u>The stipulation - Docket UG 180 (Advice No. 07-08-G)</u>
Avista held discussions with the Parties to determine what ratemaking treatment would result in a fair outcome for Avista, Glendale customers, and the rest of Avista's sales customers. The attached stipulation is the result of those discussions. Briefly, the agreement is that beginning November 1, 2007, Avista should be allowed to recover up to $122,000 of the annual revenue requirement associated with the Glendale conversion. This amount represents the average annual difference between the price of natural gas and the higher cost of propane that Avista had to purchase in order to serve Glendale. As Glendale is now served by natural gas the higher cost of propane will be removed from the gas costs borne by all customers. As a result, this proposal will result in a zero net rate change for customers. Additionally, Avista has agreed to absorb both the revenue requirement accrued from September to November 1, 2007, as well as the difference between the actual annual revenue requirement and $122,000. Parties agreed that this proposal is reasonable and should continue until new rates are established within the context of a general rate case. At that time the rate base will be adjusted to include this project less any appropriately deducted depreciation, previously collected revenue requirement, and applicable Business Energy Tax Credit.

<u>Schedule 495 - Docket UG 180 (Advice No. 07-08-G)</u>
Partial recovery of the annual revenue requirement as agreed to in the above described stipulation is accomplished through this schedule. The rate increment reflects the result of $122,000 divided by Avista's estimated annual sales therms for the PGA year. Schedule 495 requires Avista to establish a balancing account to capture the difference between $122,000 and the actual revenue it collects. The imbalance will occur due to the difference between estimated and actual sales. Annually, Avista agrees to file an

[6] See the Staff memo for Item CA2. Advice No. 07-02-G

updated tariff to modify the rate to reflect estimated annual sales therms for the upcoming PGA period and to true-up any remaining balance from the prior year. This process will continue until the Schedule retires, which is either when new rates go into effect as a result of a general rate case or in the unlikely event the investment has been fully depreciated before a general rate case is filed.

Request to establish a deferral account - Docket UM 1346
In accordance with the negotiated requirements of Schedule 495, Avista requests authorization to defer for the PGA year, the difference between the actual revenue collected from customers under Schedule 495 and $122,000.

As mentioned above, Parties stipulated that Avista be allowed to recover up to $122,000 of the annual revenue requirement associated with the Glendale conversion beginning November 1, 2007. This amount is based on an investment amount of approximately $1.3 million to perform the conversion.

Absent this deferral, any over or under collection from the Company's estimate will be absorbed by the Company until its next general rate proceeding and Avista will need to file a modified Schedule 495 to remove the requirement that it establish a balancing account to collect the difference between $122,000 and the amount it actually collects from customers. The deferral of these cost and revenue differences minimizes the frequency of rate changes and appropriately matches costs borne and benefits received by ratepayers, consistent with ORS 757.259(2)(e).

PROPOSED COMMISSION MOTION:

Avista Utilities' request for: (1) amortization of deferred accounts, base gas cost changes, and other rate changes as requested in Docket UG 178 be approved; (2) the associated tariff sheets of Advice No. 07-07-G Supplemental be allowed to go into effect with service on November 1, 2007, and the L.S.N. application be approved; (3) reauthorization to use deferred accounting pursuant to Schedule 461 be approved; (4) the stipulation related to proposed ratemaking treatment be adopted and Schedule 495 be allowed to go into effect as filed in UG 180 (Advice No. 07-08-G); and (5) a deferral account as filed in UM 1346 be authorized.

Attachment A

ORDER NO. 07-477

Avista Utilities
Oregon Gas Operations
Summary of Present and Proposed Rates

					Change in Gas Costs			Change in Amortization			Total Change		
Line No.	Description	Rate Sch	Adjusted Sales Therms	Present Revenues	Commodity Portion	Demand Portion	Total Change	Remove Old	Add New	Total Change	In Rates	In Revenue	Proposed Revenues
	(A)	(B)	(C)	(D)	(E)	(F)	(G) (E) + (F)	(H)	(I)	(J) (H) + (I)	(K) (G) + (J)	(L) (M) - (D)	(M)
1	Residential	410	50,196,496	$ 77,681,729	$ (0.09714)	$ 0.01215	$ (0.08499)	$ (0.06843)	$ 0.13188	$ 0.06345	$ (0.02154)	$ (1,081,233)	$ 76,600,496
2	General	420	29,034,263	$ 40,430,744	$ (0.09714)	$ 0.01215	$ (0.08499)	$ (0.06843)	$ 0.13188	$ 0.06345	$ (0.02154)	$ (625,398)	$ 39,805,346
3	Large General	424	3,870,969	$ 5,140,142	$ (0.09714)	$ 0.01215	$ (0.08499)	$ (0.06843)	$ 0.09694	$ 0.02851	$ (0.05648)	$ (218,632)	$ 4,921,509
4	Emergency Instit.	430	0	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
5	Interruptible	440	4,059,316	$ 4,141,761	$ (0.09714)	$ -	$ (0.09714)	$ (0.02412)	$ 0.04856	$ 0.02444	$ (0.07270)	$ (295,112)	$ 3,846,648
6	Seasonal	444	187,100	$ 244,890	$ (0.09714)	$ 0.01215	$ (0.08499)	$ (0.06843)	$ 0.09694	$ 0.02851	$ (0.05648)	$ (10,567)	$ 234,322
7	Special Contract	447	2,765,015	$ 278,412	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 278,412.00
8	Firm Transportation	455	0	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
9	Int. Transportation	456	33,080,243	$ 2,333,421	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 2,333,420.92
10	TOTAL		123,193,402	$ 130,251,097								$ (2,230,943)	$ 128,020,155
11	Residential	410	50,196,496	$ 77,681,729	$ (4,876,088)	$ 609,887	$ (4,266,200)	$ (3,434,946)	$ 6,619,914	$ 3,184,968		$ (1,081,233)	$ 76,600,496
12	General	420	29,034,263	$ 40,430,744	$ (2,820,388)	$ 352,766	$ (2,467,622)	$ (1,986,815)	$ 3,829,039	$ 1,842,224		$ (625,398)	$ 39,805,346
13	Large General	424	3,870,969	$ 5,140,142	$ (376,026)	$ 47,032	$ (328,994)	$ (264,890)	$ 375,252	$ 110,361		$ (218,632)	$ 4,921,509
14	Emergency Instit.	430	0	$ -	$ -	$ -	$ -	$ -	$ -	$ -		$ -	$ -
15	Interruptible	440	4,059,316	$ 4,141,761	$ (394,322)	$ -	$ (394,322)	$ (97,911)	$ 197,120	$ 99,210		$ (295,112)	$ 3,846,648
16	Seasonal	444	187,100	$ 244,890	$ (18,175)	$ 2,273	$ (15,902)	$ (12,803)	$ 18,137	$ 5,334		$ (10,567)	$ 234,322
17	Special Contract	447	2,765,015	$ 278,412	$ -	$ -	$ -	$ -	$ -	$ -		$ -	$ 278,412
18	Firm Transportation	455	0	$ -	$ -	$ -	$ -	$ -	$ -	$ -		$ -	$ -
19	Int. Transportation	456	33,080,243	$ 2,333,421	$ -	$ -	$ -	$ -	$ -	$ -		$ -	$ 2,333,421
20	TOTAL		123,193,402	$ 130,251,097	$ (8,484,999)	$ 1,011,959	$ (7,473,039)	$ (5,797,365)	$11,039,462	$ 5,242,097		$ (2,230,943)	$ 128,020,155

APPENDIX A
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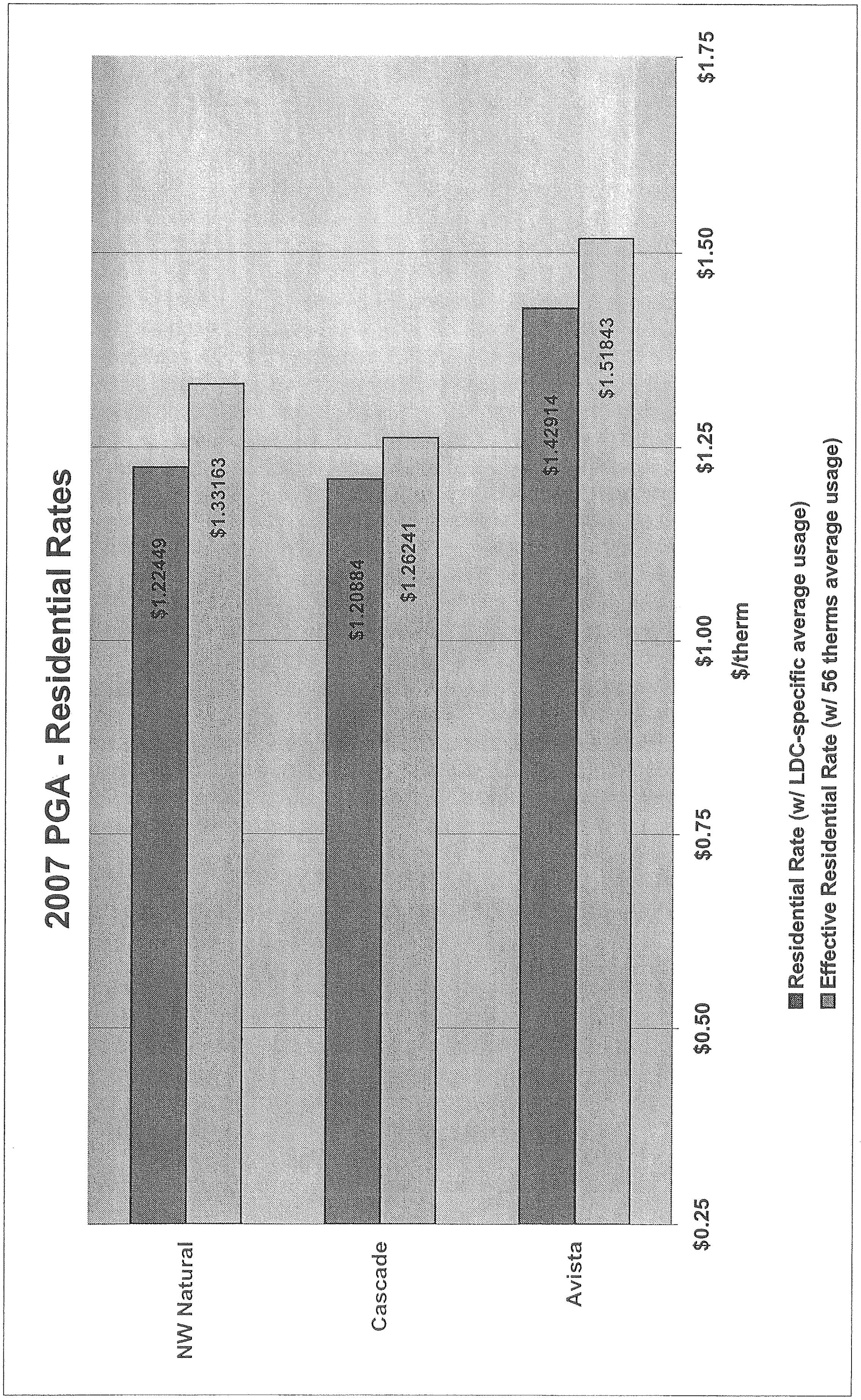
Attachment B

Comparison of Proposed Rate and Bill Increases for Oregon Local Distribution Companies by Class of Service
(November 2007 PGAs)

Class of Service	Rate Schedule	RATE IMPACTS: Current Rate per Therm	Proposed Rate per Therm	Change Rate per Therm	%-Change Rate per Therm	BILL IMPACTS: Average January Therms	Customer Charge	Current January Bill	Proposed January Bill	Change January Bill	%-Change January Bill	Annual Therms/ Month	Customer Charge	Current Monthly Bill	Proposed Monthly Bill	Change Monthly Bill	%-Change Monthly Bill
Residential																	
Avista	410*	$1.44931	$1.42914	-0.02017	-1.4%	98	$5.00	$147.03	$145.06	-$1.97	-1.3%	51	$5.00	$78.91	$77.89	-$1.02	-1.3%
Cascade	101	$1.19900	$1.20884	0.00984	0.8%	113	$3.00	$138.49	$139.60	$1.11	0.8%	60	$3.00	$74.94	$75.53	$0.59	0.8%
NW Natural	2	$1.34052	$1.22449	-0.11603	-8.7%	112	$6.00	$156.14	$143.14	-$13.00	-8.3%	56	$6.00	$81.07	$74.57	-$6.50	-8.0%
Commercial																	
Avista	420*	$1.36555	$1.34538	-0.02017	-1.5%												
Cascade	104	$1.10317	$1.10819	0.00502	0.5%												
NW Natural	3	$1.24436	$1.12149	-0.12287	-9.9%												
Industrial																	
Avista	424	$1.30913	$1.25402	-0.05511	-4.2%												
Cascade	105	$1.06455	$1.04579	-0.01876	-1.8%												
NW Natural	31	$0.92406	$0.81672	-0.10734	-11.6%												
Interruptible																	
Avista	440	$1.02031	$0.94898	-0.07133	-7.0%												
Cascade	170	$1.00732	$0.99242	-0.01490	-1.5%												
NW Natural	32	$0.84826	$0.74241	-0.10585	-12.5%												

* Rate Schedules 410 and 420 include the Margin Reduction Surcharge (in Rate Schedule 496) allowed under the approved Stipulation in Order No. 03-570.
In addition, all sales service customers' schedules include a new Glendale Surcharge (Rate Schedule 495).



2007 PGA - Residential Rates
NW Natural
Cascade
Avista
$1.22449
$1.33163
$1.20884
$1.26241
$1.42914
$1.51843
$0.25
$0.50
$0.75
$1.00
$1.25
$1.50
$1.75
$/therm
Residential Rate (w/ LDC-specific average usage)
Effective Residential Rate (w/ 56 therms average usage)