

Agenda Date: October 25, 2012  
Item Number: A3

**Docket:** UG-121501  
Company Name: Avista Corporation

Staff: E. J. Keating, Regulatory Analyst  
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### **Recommendation**

Issue a Complaint and Order Suspending the Tariff Revisions filed by Avista Corporation in Docket UG-121501, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.

### **Background**

On September 13, 2012, Avista Corporation (Avista or company) filed revisions to its Purchase Gas Adjustment (PGA) and deferred gas cost amortization tariffs in Docket UG-121501. The net effect of the proposed filings is a decrease in annual gas revenue of \$6.5 million or approximately 4.4 percent.

The PGA and deferred gas cost amortization mechanisms are designed to pass through to customers the utility's actual cost of natural gas on a periodic basis. The PGA establishes for the upcoming year a projection of the utility's gas costs reflected in Schedule 156.<sup>1</sup> The difference between the projected cost from the previous PGA filing, and the actual cost incurred for the period, is deferred and ultimately amortized back to customers with interest, as a refund or a surcharge reflected in Schedule 155.

Schedule 155 includes approximately \$384,000 left to be amortized in recognition of Jackson Prairie (JP) storage and related operations and maintenance expense for the period July 1, 2011, through December 31, 2011, consistent with Order No. 7 in Dockets UE-100467 and UG-100468 (consolidated). The Order states:

...The revenue requirement associated with Avista's rate of return applied to the actual balance of the additional JP working gas inventory applicable to Washington gas operations shall be calculated as a deferred cost beginning May 1, 2011 to be recovered in the Company's future PGA filings starting with Avista's fall 2011 PGA filing, until recovered in base rates in a subsequent general rate case. In addition, the additional operations and maintenance costs shall be recorded in the Company's PGA deferrals for later recovery in rates until those costs are included in base retail rates.<sup>2</sup>

The company recovered portions of the deferral for May 1, 2011, through June 30, 2011, in the 2011 PGA. Effective January 1, 2012, all costs associated with JP are included in base rates.

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<sup>1</sup> Schedule 150 is normally filed for changes related to the estimated cost of gas. However, due to Avista's current general rate case (Dockets UE-120436 and UG-120437) Schedule 150 is suspended and Schedule 156 has been filed in its place.

<sup>2</sup> *Utilities and Transportation Commission v. Avista Corporation*, Docket UE-100467 and Docket UG-100468 consolidated, Order 07 (November 19, 2010) Page 12

Avista, a combined electric and gas utility, serves approximately 149,000 gas customers in Eastern Washington.

## **Discussion**

### **Purchase Gas Adjustment**

Avista's Schedule 156 reflects the projected costs of purchased gas for the coming year; November 2012 through October 2013. In its filing, the company proposes an estimated residential weighted average cost of gas (WACOG) of \$0.43472 per therm (\$0.33052 commodity and \$0.10420 demand) resulting in an estimated overall annual decrease in sales revenues of approximately \$6.0 million.

In arriving at an estimated commodity cost for the coming year, the company uses a variety of known and estimated inputs. Known inputs include volumes of gas to be delivered within the PGA year hedged at a fixed price, actual cost and volume of gas in storage, and to some extent the remaining expected load transacted at spot market prices or hedged at a fixed price through financial instruments. Estimated inputs include load for the PGA year, future spot/index market prices and prices for financial hedges that will be transacted in, and for, the PGA year.

The term "hedging" as staff is using it refers to the conversion of a future supply contract at market prices to a fixed price through the use of financial instruments.

Financial instruments known as hedges have the *potential* to mitigate risk of rising natural gas prices by locking in an assumed low fixed price now. However, in a declining natural gas price environment, financial hedging has the *potential* to lock in "above market" prices for gas customers.

Approximately 41 percent of Avista's estimated annual load requirements are financially hedged at a fixed price. The portion hedged is comprised of: one-year or less financial hedges representing about 10 percent of the volume, and prior multi-year financial hedges representing about 31 percent of the volume.

The remaining balance of Avista's estimated annual load is based on the price of gas stored in Jackson Prairie (22 percent) and estimates of remaining load to be transacted at index/spot market prices (37 percent.) Avista uses a 30-day historical average of forward prices, ending September 6, 2012, by supply basin to develop the estimate of index/spot purchases. In today's filing Avista's estimated commodity costs are projected to decrease by \$0.0303 per therm from the current commodity cost of \$0.36082 to \$0.33052 for the upcoming period, November 2012 to October 2013.

Demand costs represent the cost of pipeline transportation to the company's system. Projected demand costs decreased approximately \$0.0047 per therm for residential and small commercial users (Schedule 101). The net decrease was the result of the increase in Northwest Pipeline rates, the decrease in costs for the Canadian pipelines (Alberta and Spectra), and credits for an increasing estimated pipeline capacity release.

### **Out of cycle PGA**

In February 2012, Avista filed an out of cycle PGA to reduce commodity costs from \$0.41511 that took effect on November 1, 2011, to \$0.35949 that took effect on March 1, 2012. The

combined filings in February 2012 and the current proposal would result in a decrease in commodity costs for 2012 of \$0.08459 per therm or approximately 20 percent.<sup>3</sup> The net effect of the prior out of cycle 2012 PGA filing and the current PGA filing results in a decrease in rates for residential natural gas customers using approximately 68 therms per month or 10 percent for 2012.

### Deferred Gas Cost

Schedule 155 reflects the gas cost deferral accumulated during the prior years. Currently Avista has an over-collection or deferred refund balance of \$5.6 million. Avista is proposing to increase the current refund rate of \$0.03031 by \$0.00291 to \$0.03322. As mentioned above, recognition of additional Jackson Prairie storage and related operations and maintenance expense, for the period July 1, 2011, through December 31, 2012, decreased the refund balance approximately \$384,000.

### Revenue and Residential Bill Impacts

The combined effect of the tariff change for Schedules 156 and 155 is an overall revenue decrease from gas sales customers of approximately \$6.5 million or 4.4 percent.

The impact of this filing on a residential customer with monthly average consumption of 68 therms is a decrease of \$2.58 per month or 4.3 percent, for a revised bill of \$58.18 versus a current bill of \$60.76.

Customer Class	Schedule Number	Schedule 156 PGA	Schedule 155 Deferral Amortization	Total Revenue Impact	Percent Change
Residential	101	(\$4,163,481)	(\$346,362)	(\$4,509,843)	
Commercial	111	(\$1,588,556)	(\$41,924)	(\$1,630,480)	
Industrial-Firm	121 & 122	(\$212,384)	(9,087)	(\$221,471)	
Interruptible	132	(\$21,254)	\$1,177	(\$20,077)	
Transportation	146		(\$79,066)	(\$79,066)	
<b>Total Change</b>		<b>(\$5,985,675)</b>	<b>(\$475,262)</b>	<b>(\$6,460,937)</b>	<b>(4.41%)</b>

### Cause for Suspension

In addition to actual spot/index market prices, financial hedging costs and the percentage of volumes hedged are a component in the cost of gas passed on to ratepayers. The last few years have seen a sharp decline in natural gas prices with a slower decline in the cost of gas passed on to ratepayers. There is the possibility that locking in prices of future gas supplies through financial hedging has led to commodity costs passed on to ratepayers being significantly higher than what would have been absent financial hedging or at least a decrease in the volumes hedged. Commission staff has not pre-determined prudence, or lack thereof, for any of the natural gas utilities regulated by this commission. And it should be noted that financial hedging in the face of rising natural gas prices could benefit ratepayers.

<sup>3</sup> All costs are before revenue sensitive items

In order to determine that commodity costs passed on to ratepayers are fair, just, reasonable, and sufficient, commission staff has determined that a thorough review of financial hedging activities and policies of all natural gas utilities regulated by this commission is needed at this time. Therefore staff is requesting suspension of this filing, along with the PGA filings of other investor-owned utilities in order to allow for more time to review hedging transactions, potential implication of procurement/hedging guidelines and uniformity of PGA reporting. Potential areas of review include, but are not limited to:

1. Guidelines for implementing portfolio purchases of natural gas.
2. Guidelines for the level and type of financial hedging of natural gas prices.
3. Guidelines for documentation of financial hedging decisions.
4. Guidelines for the sources and methodology for forecasting long-term natural gas prices.
5. Guidelines for the source and methodology for the forecasts of spot (cash) natural gas prices included in the PGA.
6. Guidelines for the use of storage as part of the company portfolio of natural gas.
7. Guidelines for documentation of natural gas market reviewed by the company in making purchasing decisions.
8. Sharing of gas financial hedging costs between the company and its customers and the percentage for such sharing.
9. A common format for PGA filings with the commission.
10. Common formats for PGA work papers that support the filing with the commission.

### **Customer Comments**

Avista notified its customers of the anticipated rate decrease by bill insert beginning on September 21, 2012. The commission did not receive any comments on this filing.

### **Conclusion**

Issue a Complaint and Order Suspending the Tariff Revisions filed by Avista Corporation in Docket UG-121501, and allow the tariff revisions to become effective on November 1, 2012, on a temporary basis, subject to revision.