BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

REBUTTAL TESTIMONY OF ROBERT H. GRUBER (RHG-3T)

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, employer and business address.

A. My name is Robert H. Gruber. I am employed as Manager of Natural Gas Resources by Avista Corporation at 1411 East Mission Avenue, Spokane Washington.

Q. Have you previously submitted testimony in this Docket?

A. Yes. I have provided prepared direct testimony marked for identification as (RHG-1T) and Exhibit ______ (RHG-2)

Q. Please describe the nature of your rebuttal testimony in this proceeding.

A. My rebuttal testimony will respond to a number of concerns expressed by the Commission Staff (Staff) and Public Counsel (PC) regarding the proposed continuation of the Benchmark Mechanism. While there are a number of areas that I will address, there are two areas that require primary focus. The first is Staff's assessment of the cost of supplying the Tier 3 intra-month daily load volatility. Due to several serious flaws in Staff's analysis, it has reached the incorrect conclusion that moving this function back into the Utility would reduce costs to customers. The second area of major concern is with both Staff's and PC's analysis of the value of capacity releases and off-system sales. Errors in this analysis have resulted in a significant overstatement of the value of available transportation for capacity release and off-system sales.

I will also address concerns related to a benchmark against which costs are measured, and the use of "actual costs" in the Mechanism. Additionally, I will respond to the alternatives recommended by Staff and Public Counsel.

Q. How does Staff's position differ from the Company's analysis of the benefits of the Benchmark Mechanism to Avista Utilities' customers?

A. Staff suggests that the Utility could adopt the same purchasing strategy for natural gas procurement and provide more benefits to customers than are being proposed under the Mechanism. At page 7 of my prepared direct testimony I offered a table which identified the costs of bringing the gas procurement functions back to the Utility. The table showed a benefit to customers from a continuation of the proposed Mechanism of approximately $2.6 million annually. Staff has conducted its own analysis and has suggested that it would save Avista Utilities' customers approximately $1.6 million annually to move the natural gas procurement functions back into the Utility. Table 1 below summarizes the differences in the Company's and Staff's figures:

Table 1
Estimated Annual Incremental Costs Associated with
Natural Gas Procurement Managed by the Utility vs. Avista Energy

	Avista Utilities Managing Gas Procurement	
	Company Table per (RHG-1T)	**Staff Table per Exhibit (MPP-8)**
Expense Category		
Employee (loaded labor plus support costs)	$408,500	$408,500
Credit	$512,500	$512,500
Premium for Physical Delivery	$123,200	$123,200
Currency	$176,000	$ 0
Load Volatility	$231,000 (1)	($1,759,855) (2)
Estimated Loss of Transportation Benefits	$2,000,000	$ 0
Subtotal of Benefits to Utility Customers	$3,451,200	($715,655)
Proposed Management Fee	($900,000)	($900,000)
Net Additional Costs (Benefits) if Procurement Operations were to return to the Utility	$2,551,200	($1,615,655)

(1) This valuation represents the costs associated with the daily swing around the average load due to customer load volatility that is borne by Avista Energy (net of shared total basin optimization benefits).
(2) This valuation is Staff's revision to Avista Energy's estimated share of the daily swing around the average due to customer load volatility (net of shared total basin optimization benefits, winter summer differential, storage peaking benefits, and capacity release/off-system benefits). Costs are positive numbers benefits or savings are in brackets.

As can be seen from the table above, the major differences between the Company and Staff are the analyses of costs related to covering Load Volatility (Tier 3 transactions under the

Mechanism to cover daily load volatility), and the benefits from Transportation (capacity release and off-system sales).

Q. After reviewing Staff's analysis, do you agree with the figures that it has presented?

A. No. As I will explain later in my testimony, Staff's conclusion that there is essentially no cost to covering daily load volatility is completely out of step with the reality of serving weather-sensitive loads in a volatile market where prices are heavily influenced by supply and demand. In addition, I will explain why Staff has understated the benefits from capacity releases and off-system sales with the continuation of the Benchmark Mechanism. Mr. Parvinen's analysis led him to the incorrect conclusion that there is essentially no benefit being provided to Avista Utilities from Avista Energy's management of available pipeline transportation, as reflected in the zero value for transportation in the table above.

Q. Before addressing these two issues, do you have any initial comments on the analyses prepared by Ms. Elder on behalf of Public Counsel?

A. Yes. Although I will respond to a number of issues raised by Ms. Elder, I am most concerned about the major errors in assumptions in her analysis related to capacity releases and off-system sales. These errors have led to a significant overstatement of the benefits that could be achieved from the available transportation, and I will take up this issue of capacity release/off-system sales first since the analyses of both Ms. Elder and Mr. Parvinen contain major incorrect assumptions.

Q. Please begin.

A. With respect to Ms. Elder's analysis, her calculations suggest that Avista Energy should be able to achieve $10 million annually in capacity release revenues. There are a number of errors in her analysis. First, the average Tier 1 and 2 loads per day in her calculation are for our combined Washington and Idaho jurisdictions. Without an adjustment for a

Washington state jurisdictional allocation, this is not the appropriate starting point for a calculation of the basis for Washington capacity release revenue.

Second, Ms. Elder uses the difference between the <u>average load</u> for each month and the total capacity from each of Avista's transportation contracts as being available for release. This assumes the release of capacity necessary to cover load swings above average load, e.g., during periods of cold weather. Any capacity that is necessary to serve these loads must be either retained or released on a short notice recallable basis. Recall rights on a release agreement substantially reduces its value.

Third, and the most troubling issue, is Ms. Elder's actual calculation of the value of the capacity release. In Ms. Elder's confidential Exhibit ____ (CME-4C) the total capacity release (Release/OS) revenue is calculated at $0.69 per Dth. FERC regulations and the resulting pipeline tariffs limit the recovery of capacity release revenue to the maximum pipeline tariff, which in Northwest Pipeline's case is currently $0.27760 per Dth.

Furthermore, local distribution companies (LDC's) hold the bulk of the capacity on Northwest Pipeline. Most LDC's have an annual load factor of between 35% and 40%. Almost all are very long on capacity in the off-peak months. This glut of capacity on the system between March and October results in downward pressure on the value or market price of released capacity. Unless the capacity to be released has a primary path through a major constraint point on the pipeline, and there is a price difference for commodity across that constraint point, the capacity release value is minimal in the summer. The same holds true for capturing value of transportation through off-system sales, unless the capacity is through a major constraint point the value is substantially diminished. Therefore, Ms. Elder's analysis severely overstates the value that could be captured in the market place from the Utilities' available transportation.

Q. Please explain your disagreement with Mr. Parvinen's analysis of the benefits from capacity release and off-system sales.

A. Through his analysis Mr. Parvinen reduced the "Estimated Loss of Transmission Benefits" in Table 1 above from $2.0 million to zero. In addressing the Company's estimates, on page 36 of his testimony, beginning on line 16, he states:

> "…the Company's calculation uses Avista Energy's actual capacity release/off-system sales revenue for the period the Mechanism was in place. While this is an actual figure, it is not a representative one. This period included two months during the "Energy Crisis" in which Avista Energy was able to capture approximately $10.4 million in net benefits. This anomaly should be excluded from the evaluation of what the Utility could achieve compared to Avista Energy. My presentation in Exhibit No._____(MPP-8) excludes this anomaly."

Q. How is Mr. Parvinen's proposal to exclude this "anomaly" relevant to his overall analysis?

A. In developing his recommendation to reduce the Transportation Benefits in Table 1 above from $2,000,000 to zero, Mr. Parvinen includes inconsistencies in his analysis with regard to this anomaly.

In his response to Avista Corp. Data Request No. 6 attached as Exhibit ____ (RHG-4) Mr. Parvinen, with regard to estimates for capacity release/off-system sales, states:

> "Line 6 is an estimate of the going forward, normalized level of costs and benefits that the utility would expect to incur and realize if the Mechanism were to revert back to the utility."

The flaw in Mr. Parvinen's analysis is that while he reduces the benefits that Avista Energy actually accrued during this "anomaly period" he does not reduce the level of benefits that he assumes the utility would have achieved during this same period.[1] It is not appropriate

[1] These calculations are shown on Mr. Parvinen's confidential Exhibit ____ (MPP-9C).

to normalize one side of the analysis while not normalizing the other side of the analysis. We believe that by normalizing both sides of the analysis the benefits would remain at $2,000,000 in Table 1 above, and should not be reduced to zero as proposed by Mr. Parvinen.

Q. Please explain the incorrect assumptions inherent in Mr. Parvinen's adjustment in Table 1 above related to Load Volatility.

A. Before I address Mr. Parvinen's analysis related to Load Volatility, it is important to first understand what the Load Volatility line on Table 1 represents, as well as what Mr. Parvinen is proposing through his adjustment. Although there are a number of elements that make up the figures included on the Load Volatility line, the primary difference between the Company's $231,000 figure and Mr. Parvinen's figure of negative $1,759,855 is the estimated costs associated with covering Avista Utilities' daily load volatility.

Under the Benchmark Mechanism this volatility is covered by Tier 3 daily purchases and sales, as well as injections and withdrawals from storage. It is important to note, however, that the total cost to cover this daily load volatility is much greater than the Company's figure of $231,000 shown in Table 1. <u>The $231,000 on Table 1 represents the 20% of net costs that Avista Energy is absorbing for this component of the Benchmark Mechanism through the 80%/20% sharing mechanism, and therefore, is one of the benefits to customers through the Mechanism.[2] If the gas procurement operations were to be moved back into the Utility, this additional cost would be borne by Avista Utilities' customers.</u>

Through Staff's adjustment of a negative $1,759,855 in Table 1 above, it is proposing that there is no cost to cover this daily load volatility. We very strongly disagree with this assumption.

Q. What does Mr. Parvinen use as the explanation for this adjustment?

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[2] As indicated in Note 1 of Table 1, this valuation represents the costs associated with the daily load volatility that is borne by Avista Energy, net of shared total basin optimization benefits.

A. In Mr. Parvinen's testimony at page 33, line 3, Mr. Parvinen states that this reduction is justified by the following:

> "The company calculation ignores their ability to use storage to mitigate volume volatility. Yet the Mechanism allows for daily withdrawals of storage as well as injections into storage."

Mr. Parvinen's assumption that Avista failed to take into account the ability to use storage, however, is incorrect. The Company included the economic dispatch of storage to mitigate daily purchases in its analysis, and labeled it as a "Peaking Benefit" under the Storage Component on Confidential Work Paper 5 that was provided to Staff. This work paper is attached as Confidential Exhibit _____(RHG-5C). This "Peaking Benefit" is the benefit from the use of storage to manage Tier 3 volatility. Furthermore, on page 4 of my prepared direct testimony in this Docket, I stated as follows with regard to the use of storage:

> <u>"Storage would also be used to mitigate high day prices and cover some load swings with a primary focus on maintaining deliverability for peak day reliability because approximately one-third of core peak day requirements are covered with storage."</u> (underscore added)

In fact, Mr. Parvinen has included the benefits from this use of storage in two places on his confidential Exhibit ____ MPP-9C, once to reduce the Load Volatility to zero (Line 3), and a second time to account for the storage Peaking Benefit (line 5). Therefore, Mr. Parvinen has double-counted these benefits.

Q. Are there additional flaws in Mr. Parvinen's analysis related to the costs to cover daily load volatility?

A. Yes. In addition to the double-counting of storage benefits, Mr. Parvinin uses his "judgement" with no supporting calculations to support his assumption that the cost to serve daily load volatility is zero. This can be seen in the following series of statements provided by Mr. Parvinen:

In his testimony on page 33, line 8, Mr. Parvinen states:

"On certain days, when actual load is less than the average expected load, the excess gas can be injected into storage at the purchase price based on FOM index. The excess gas can later be withdrawn on days when actual load requirements are above the average expected load, at the same price as when it was injected into storage. The result is the Tier 3 load volatility would be met at FOM index pricing, resulting in no additional cost for this component beyond the FOM index price."

At page 33, line 18, of his testimony Mr. Parvinen states:

"Because every day of every month will not be average, in some months there will be no space in storage to physically inject gas. Likewise, there will be times when stored gas will be unavailable for withdrawal. On the other hand there will also be times when gas will not be injected because it can be sold at a higher price than the FOM index price. At other times, gas will not be withdrawn from storage to meet the daily load volatility because it can be bought more cheaply than the FOM index price. <u>In my analysis, I assume these 'positive' situations can offset the times when physical constraints create actual cost beyond the FOM index.</u>" (underscore added)

Finally, in his response to Avista Corp. Data Request No. 1, attached as Exhibit_____(RHG-6), Mr. Parvinen states:

"...<u>in his [Mr. Parvinen's] judgment</u>, there are situations in which a net benefit occurs that can offset those situations when a net cost occur. <u>To form his judgment, Mr. Parvinen made no specific calculation to measure the positive situations described in his testimony</u>." (underscores added)

In contrast, the Company provided detailed calculations to Staff of the costs to cover this Tier 3 load volatility. The total cost of Tier 3 load balancing was included in the confidential Work Paper 5, which I referred to earlier, and is attached as Exhibit No. ____ (RHG-5C).[3] The analysis, on line 3 of Exhibit ____(RHG-5C), shows that the total cost to

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[3] The confidential Work Paper 5 detailed analysis was provided to the Staff as an attachment to the WUTC Data Request 45 in the MS Excel file Benchmark Model V4_3.xls.

cover the Tier 3 load volatility is approximately $2.3 million per year. Mr. Parvinen has arbitrarily zeroed out these costs with no specific calculations to support his analysis.

Q. Would you please briefly describe the nature of this daily load volatility and what drives the cost to serve this load?

A. Yes. As Mr. Norwood explained through his Exhibit ____ (KON-4), prior to entering a month, the Company has already purchased a sufficient amount of natural gas to equal the expected average load for the month. Once we enter the month, the majority of the time the actual load is different, higher or lower, than the estimate. Daily purchases or sales, together with the use of storage, are used to balance total supply with total load on a daily basis. The costs associated with this daily load balancing is not zero, however, as suggested by Mr. Parvinen.

As an example, when we encounter a cold spell for a week in December, Avista Utilities' retail loads, which are weather sensitive, will increase substantially above the average. In addition, other regional LDCs will see increases in loads from the cold spell. Furthermore, the cold temperatures will cause weather-sensitive electric loads to increase and cause increased gas-fired peaking generation to come on-line. These increases in loads cause a substantial increase in demand for the natural gas wholesale market, which generally drives the daily prices higher. Therefore, when daily loads are higher than the average, unless additional storage withdrawals are available and economic, the Company must purchase from the higher-priced daily market to cover this daily load volatility.

On the other side of the equation, when temperatures within the winter months are warmer than normal, it results in Avista Utilities' loads being below the monthly average, as well as the loads of other regional LDCs. Additional gas-fired thermal plants in some cases will also be off-line. This broad decline in natural gas loads creates a temporary surplus in supply, which applies downward pressure on prices. Thus, when daily loads are lower than the average, unless additional storage injections are possible and economic, the Company must sell its surplus natural gas in the lower-priced daily market to balance its daily load.

Obviously there are exceptions to these conditions, but in general terms, for daily load balancing the Company must purchase in a higher-priced market to cover the higher loads, and must sell its surplus daily gas in a lower-priced market, which results in a net cost to cover this daily load volatility. That is the unfortunate reality of the economics of supply and demand. As I stated earlier, the Company has provided extensive analysis to support the estimated annual cost of $2.3 million, as shown on line 3 of Exhibit ____ (RHG-5C), to cover this daily load volatility.

Therefore, Mr. Parvinen's assumption that the cost to serve this daily load volatility is zero should be dismissed, and the negative $1,759,855 proposed by Mr. Parvinen in Table 1 above should be changed to a number comparable to the positive $231,000 provided by the Company.

Q. How would Mr. Parvinen's figures in Table 1 above change if adjustments were made to correct his assumptions related to capacity release/off-system sales and daily load volatility as explained above?

A. Mr. Parvinen's figures suggest a total net benefit of $1,615,655 to move the natural gas procurement operations back into the Utility. When we add back $2.0 million related to the capacity release/off-system sales, and $1,990,855 (the difference between a positive $231,000 and a negative $1,759,855) related to daily Load Volatility, it would change Mr. Parvinen's $1,615,655 net benefit to a net cost of $2,375,200, i.e., there would be a net cost to Avista Utilities' customers of $2.4 million annually to move the gas procurement operations back into the Utility. This is close to the Company's estimated additional cost to customers to move the gas procurement functions back into the Utility of approximately $2.6 million annually.

Q. What is your response to Mr. Parvinen's proposal in Table 1 above to reduce the costs associated with the Canadian currency exchange from $176,000 to zero?

A. As set forth in my prepared direct testimony, this line reflects the currency risk exposure of having a large portion of our portfolio based at the AECO Canadian supply basin in US dollars. It reflects the continuing risk of changes in the exchange rate between US currency and Canadian currency. On page 32, line 15, of his testimony, Mr. Parvinen again explains that he is relying on assumptions and "logic" to reduce the cost of currency to zero as follows:

> "In fact, <u>as a matter of logic</u> this item should be zero because <u>there should be</u> an equal chance of currency changes both up and down." (underscores added)

Although it is true that the currency exchange rates change both up and down over time, our historical experience with the currency exchange has shown a net cost to the Company. Our analysis, which we have provided in supporting work papers, shows that the cost exposure is approximately 1 cent per Dth purchased in Alberta, which equates to approximately $176,000 per year.

It should be noted that in the 12 month period from August 1, 2002 through August 1, 2003 the Canadian currency strengthened against the US dollar by approximately 8.6 cents. (source Platts Gas Daily) At a gas cost of $5.00 this is a currency risk exposure of $0.43 per Dth ($5.00/Dth x 0.086). Avista believes that it is unreasonable to ignore this shift. Currency, like gas costs, goes up and down and if the desire is some stability in pricing, currency exchange rates can and should be hedged. While purchasing gas in the monthly and daily market, the exposure to the $0.43 per Dth referenced above would be mitigated to some extent, the Company's estimate of 1 cent per Dth is conservative for an annual exposure and should remain as part of the cost/benefit structure. Currency risk is a real cost and should be retained as a cost of providing service under the Benchmark Mechanism.

Q. Staff has provided an example of how a Tier 3 transaction is not based on Avista Energy's actual costs. Are the Utility's customers disadvantaged or in any way injured by this situation.

A. No. The example provided by Staff on page 26, lines 1 through 17, of Mr. Parvinen's testimony describes a situation where the Utility load is above Tier 2 average load, and the Utility required 5,000 therms of Natural gas at Sumas. The Utility would be charged at Avista Energy's average actual purchase price at Sumas that day. If Avista Energy was long in their portfolio and did not need to purchase gas at Sumas that day, the gas would be delivered to the Utility at the Sumas index price for that day. I have paraphrased Mr. Parvinen's example but I have not changed the parameters.

To get to this situation several things have already occurred. Basin Optimization has occurred and the value of underutilized transportation capacity and lower cost commodity from other basins has been captured. The benefits of this Basin Optimization are tracked through to customers. Also, economic dispatch of storage has occurred and if it was economic, higher cost peaking supplies have been offset with storage and the benefits have been tracked through to customers. At this point the lowest-cost supply basins have been optimized and the value captured for the benefit of customers, and there are no other lower cost alternatives than to purchase gas at the highest cost basin, which in this example is Sumas. If the Utility were managing the procurement function, the Utility would also have to purchase the gas in the above example at Sumas. Although customers, in this example, receive some purchases from the highest-cost supply basin, they also receive the benefits from the optimization of the other lower-cost supply basins. On a net basis, all of these transactions work together to create an overall lower cost for the Utilities' customers.

In addition, as we have noted before, these Tier 3 transactions represent a relatively small +/- 8% of the annual consumption for core customers.

Q. Do you agree with Staff's criticism that the Benchmark results in an inability to track actual costs in all Tiers?

A. No. As Mr. Norwood has explained, the cost of natural gas in Tier 1 is fixed, based on a series of hedges executed on behalf of the Utility, that are transaction specific and clearly traceable and auditable. Likewise all purchases for Tier 2 at FOM are Utility specific deals that can be tracked and audited.

Staff seems to be concerned that because Avista Energy balances daily deliveries out of their portfolio, the molecules that were purchased at a specific price may be different than the molecules that are actually delivered. If Avista Energy or the Utility contracts for natural gas deliveries from a supply basin at a specific price and gas is delivered at that price, the contract is fulfilled irrespective of where the molecules come from. Therefore, Staff's criticism that the Benchmark results in an inability to track actual costs in all Tiers is unfounded, or at a minimum is immaterial to the analysis of whether the Benchmark Mechanism is in the best interest of Avista Utilities' customers.

Q. Have you developed any additional procedures to address Staff's concern about tracking Prices?

A. Yes, Avista Utilities and Avista Energy have developed and proposed the use of a Daily Log for reporting purposes where each day the individual deals are reported for each Tier and result in a tracking of costs for all volumes. This report will be prepared each day by an employee of the Utility based on hedged deals and storage in Tier 1, specific assigned transactions at FOM for Tier 2 and specific deals or index specific daily deals in Tier 3. The report will be compiled daily for a monthly and quarterly summary to the Commission. Mr. Norwood has sponsored an example of this Daily Log as Exhibit ____ (KON-5). This tool will provide the Utility and the Commission Staff a clear road map and audit trail to audit all transactions.

Q. One of the primary concerns presented by Public Counsel was that "Avista's benchmark mechanism proposal does not establish a clear benchmark for measuring Avista's success in achieving lower gas costs." [see CME-1TC page 2 line 14] Does Avista agree with this statement?

A. No. As stated by Mr. Norwood in his rebuttal testimony (KON-3T) the Benchmark Mechanism does provide a distinct external benchmark against which to compare. The benchmark is established at the value of the Tier 2 FOM price, and is further discussed in Mr. Norwood's testimony and illustrated on Exhibit ____ (KON-4). The FOM price for Tier 2 provides a fixed price starting point each month and that number is used to judge the performance of Avista Energy in Tier 3. Savings and costs above and below that point are shared on an 80%/20% basis between customers and Avista Energy. Avista Energy, therefore, clearly has an incentive to save the customers money, because they have an opportunity to share in 20% of the savings, and are at risk for 20% of the costs above the benchmark.

Q. In Public Counsel's testimony at page 15, line 13, Ms. Elder discusses the concept that customers are not getting a good deal because, as shown in her Exhibit ____ (CME-6), the reported commodity cost experienced by Avista's customers is higher than the basin weighted FOM cost. Do you agree with this statement.

A. No. First, Ms. Elder's exhibit compares Avista's commodity cost to basin weightings, which were not in effect for the period of her study. Those basin weightings were 64% AECO, 18% Rockies and 18% Sumas.

Second, Avista Utilities has chosen to move away from primary reliance on FOM index purchases because it results in a level of volatility that is unacceptable to customers and the Company. In early 2001, the Commission approved a proposal by the Company to hedge or fix the price of a portion of the natural gas purchases in advance in order to provide more price stability. In addition, the current Benchmark Mechanisms in Washington, Idaho and Oregon include such a portfolio approach in order to provide some level of price stability for customers. This portfolio approach has been proposed and adopted with the full knowledge that a partially hedged portfolio may not be the lowest cost in all cases, but it provides a reasonable level of stability.

Q. Do you agree with Ms. Elder's observation at page 20, line 6, "Based on Avista's proposal and my understanding about the evolution of the mechanism and the proposed changes to it over time, it is evident to me that Avista consistently seeks to reduce its procurement risks without admitting that it is shifting that risk to ratepayers."

A. No. While that may be Ms. Elder's understanding, it is incorrect. Avista has made changes to the Mechanism over time which make appropriate adjustments to the sharing of risk between Avista Energy and Avista Utilities' customers commensurate with the amount of compensation Avista Energy was receiving. These adjustments were never made in a clandestine manner "without admitting" the shift in risk. If the Benchmark were to revert back to the Utility, the Utility and its ratepayers would bear all the risk.

Q. Beginning on page 48 of his testimony, Mr. Parvinen has provided three alternative recommendations should the Commission decide to allow Avista Energy to continue to provide the gas procurement and capacity management functions for the Utility? Are any of these recommendations acceptable to the Company?

A. No. The alternative recommendations made by Staff are unworkable.

<u>Alternative 1</u>

Under Alternative 1 Mr. Parvinen has proposed that the gas supply management functions currently being provided by Avista Energy be put out for competitive bid. We believe this would not be in the best interest of our customers at this time for a number of reasons. First, due to all the turmoil in energy markets over the last three years many of the companies that would typically participate in this type of business have left the region or no longer exist. It would not surprise me if the RFP process received little or no interest.

Second, it took Avista Energy a good two years to fully understand all the nuances involved in serving the load. Because Avista Energy has been managing the load for the last several years they have a knowledge base and experience that they can continue to use for the benefit of Avista Utilities' customers. In addition, Avista Utilities is very concerned about maintaining control and reliability of supply, which is possible through its relationship with Avista Energy, but would be more difficult with another third party. During periods of stress in the market place or stress in the third party's financial situation the best interests of Avista Utilities' customers may not be at the level of priority that it would be with the procurement functions residing at Avista Energy or Avista Utilities.

Third, in an effort to increase the competitive nature of the bid, Staff is eliminating its ability to audit if a third party other than Avista Energy is selected. The current Mechanism is designed to match performance against market with the ability to audit, which Alternative 1 could eliminate. For these and other reasons, Mr. Parvinen's first alternative is unacceptable.

<u>Alternative 2</u>

The second Alternative proposed by Staff is to increase the guaranteed level of capacity release/off-system sales to $7 million and drop the $900,000 management fee that is paid to Avista Energy. This alternative also includes changing the basin weightings every six months, on October 1 and April 1 of each year.

The ability to generate capacity release and off-system sales revenue is a function of the cost differences between supply basins and the amount of available capacity that is underutilized in each corridor. The recent spate of pipeline expansion projects to meet the needs of new electric generation construction coupled with the postponement or cancellation of a number of electric generation projects has left the region with a short-term surplus of capacity especially in the I-5 corridor. This surplus results in a lower release/off-system sale value for the capacity held by Avista Corporation. The $7 million annual guarantee, relative to the as-available transportation capacity would not be possible for any party in the current market environment.

The $900,000 management fee paid to Avista Energy covers part of the cost of providing the service to the Utility. As shown on the Exhibit ____ (RHG-5C) the costs of providing the service combined with the management fee and Avista Energy's share of the incentive sharing nets a little less than $1 million annually to Avista Energy. This is a reasonable amount for the services provided.

The concept of changing the basin weightings is problematic because it places the Company in a position of executing hedges for the upcoming winter in October and November. This is probably the worst time from a market timing standpoint to be structuring or restructuring the winter supply portfolio. Changing basin weightings both in the spring and fall would be harmful to customers.

<u>Alternative 3</u>

The Third alternative is to have the Utility assign all transportation to Avista Energy and then have the Utility pay for only the transportation it needs. While the Utility's customers might enjoy the status of a 100% load factor shipper, the proposal would require Avista Energy to accept the risk of holding and paying for capacity that the Utility has call rights on without receiving compensation for the call rights, which would be very expensive. The proposal is completely unreasonable for any service provider to accept, especially given the low annual load factor for Avista Utilities.

Q. Does this complete your prepared rebuttal testimony?

A. Yes it does.

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

EXHIBIT ____ (RHG-4)

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF
RESPONSE TO DATA REQUEST

DATE PREPARED:	August 8, 2003	WITNESS:	Michael Parvinen
CASE NO.:	UG-021584	RESPONDER:	Michael Parvinen
REQUESTER:	Avista	TELEPHONE:	360-664-1315

AVISTA CORP. DATA REQUEST NO. 6:

At Line 7,8,9 of MPP-9C (calculation of AE's share of Capacity Opt and Off-System Sales (Total less Guaranteed level to be shared with AE 20%) Mr. Parvinen accepted and utilized capacity and off-system sales revenues provided in Workpaper 5 by Avista Utilities that is carried forward to MPP-8 to calculate the "Net Benefits if Procurement Operations Were to Return the Utility." However, Mr. Parvinen discounts the value of those benefits in lines 22,23,24 of MPP-9c (Company AE Off-System Sales margins less Nov-Dec 2000 Off-System Sales) when calculated for inclusion in Line 7 of MPP-8 entitled "Subtotal of benefits to Utility Customers." Please explain the differing treatment of the same revenues. Please fully explain your answer and include all analysis and supporting documentation.

RESPONSE:

These analyses, even though generated from the same data, were used for different purposes. Accordingly, two different forms of analysis applied.

The amount shown in Exhibit No. ___ (MPP-8), line 6 is an estimate of the going-forward, normalized level of costs and benefits the utility would expect to incur and realize if the Mechanism were to revert back to the utility. That is why the line is labeled "estimate." Because of this, the anomaly is removed in order to normalize the period, and make the estimate more realistic and defensible.

By contrast, the amount shown in Exhibit No. ___ (MPP-8), line 5 is not an estimate of the going-forward, normalized level of costs and benefits. Rather, it represents the actual net costs and benefit components paid to Avista Energy based on calculations dictated by the Benchmark Mechanism, as applied to actual achieved results.

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

EXHIBIT ____ (RHG-6)

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF RESPONSE TO DATA REQUEST

DATE PREPARED:	August 8, 2003	WITNESS:	Michael Parvinen
CASE NO.:	UG-021584	RESPONDER:	Michael Parvinen
REQUESTER:	Avista	TELEPHONE:	360-664-1315

DATA REQUESTS

AVISTA CORP. DATA REQUEST NO. 1:

On line page 34 line 6-10 of MPP-1T Mr. Parvinen states: "In my analysis, I assume these 'positive' situations can offset the times when physical constraints create actual cost beyond the FOM index." Please provide a detail of the analysis, calculations and methodology that validates this assumption. Please include all analysis and supporting documentation.

Objection: We object to this data request to the extent it shifts the burden of proof from Avista to Staff. The point Mr. Parvinen is making is that Avista's net cost assumption has no basis because there are offsetting factors. It is not Staff's burden to measure the offset. It is Avista's burden to prove there is no offset, and Avista has not borne that burden. (This objection is the responsibility of Mr. Trotter, Assistant Attorney General for the Commission in this matter)

Without waiving this objection, Staff responds as follows:

RESPONSE:

Mr. Parvinen's testimony addresses that part of Avista's analysis that assumes all volatility is purchased and sold at the Gas Daily Index, creating a net cost, as compared to the FOM index.

Mr. Parvinen challenges Avista's assumption because, in his judgment, there are situations in which a net benefit occurs that can offset those situations when a net cost occurs. To form his judgment, Mr. Parvinen made no specific calculation to measure the positive situations described in his testimony. It would be very difficult to perform such a calculation, because there are many variables that could affect the decision-

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF
RESPONSE TO DATA REQUEST

DATE PREPARED:	August 8, 2003	WITNESS:	Michael Parvinen
CASE NO.:	UG-021584	RESPONDER:	Michael Parvinen
REQUESTER:	Avista	TELEPHONE:	360-664-1315

making process.

For example, looking at December 2002, at Sumas, the monthly index was $3.96. During the last half of that month, the daily price was above the monthly index. Since the daily load was less than the average expected load, rather than inject gas into storage (the preferred method testified to by Mr. Parvinen), it may be more economical to sell the gas into the market, depending on other variables such as the level of storage (above or below synthetic schedule), expected future weather patterns, etc.

The bottom line is that it is inappropriate for Avista assume, without proof, that all volatility is purchased and sold at the Gas Daily Index, creating a net cost, as compared to the FOM index.