BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Avista Utilities for Extension of the Natural Gas Benchmark Mechanism.	Docket No. UG-021584 Volume IV Pages 58 to 109

A hearing in the above matter was held on September 23, 2003, from 3:30 p.m to 4:40 p.m., at 1300 South Evergreen Park Drive Southwest, Room 206, Olympia, Washington, before Administrative Law Judge THEODORA MACE and Chairwoman MARILYN SHOWALTER and Commissioner PATRICK J. OSHIE.

The parties were present as follows:

THE COMMISSION, by DONALD T. TROTTER, Senior Assistant Attorney General, 1400 South Evergreen Park Drive Southwest, Olympia, Washington 98504-0128, Telephone (360) 664-1189, Fax (360) 586-5522, E-mail dtrotter@wutc.wa.gov.

AVISTA CORPORATION, by DAVID J. MEYER, General Counsel, East 1411 Mission Avenue, Spokane, Washington, 99220, Telephone (509) 495-4316, Fax (509) 495-4361, E-mail dmeyer@avistacorp.com.

THE PUBLIC, by ROBERT W. CROMWELL, JR., Assistant Attorney General, 900 Fourth Avenue, Suite 2000, Seattle, Washington, 98164-1012, Telephone (206) 464-6595, Fax (206) 389-2058, E-Mail robertc1@atg.wa.gov.

Joan E. Kinn, CCR, RPR
Court Reporter

INDEX OF EXAMINATION

WITNESS:	PAGE:
KELLY O. NORWOOD	80
MICHAEL PARVINEN	92
CATHERINE ELDER	102

INDEX OF EXHIBITS

EXHIBIT:	MARKED:	ADMITTED:
KELLY O. NORWOOD		
1T		65
2		65
3RT		65
4		65
5		65
6		65
7		65
8		65
9		65
10		65
11		65
12		65
13		65
14		65
15		65
16		65
17		65
18		65
19		65

20		65
21		65
	ROBERT H. GRUBER	
51T		65
52		65
53RT		65
54		65
55C		65
56		65
57C		65
58		65
59		65
60		65
61		65
62C		65
63		65
64		65
	MICHAEL D'ARIENZO	
101T		65
102RT		65
103C		65
104		65
105		65
106		65
107		65

108		65
109C		65
110		65
111C		65
112		65
113		65
114		65
115		65
116		65
117		65
118		65
119		65
	BRIAN J. HIRSCHKORN	
151T		65
152		65
153		65
	MICHAEL P. PARVINEN	
201T		65
202		65
203		65
204		65
205		65
206		65
207		65
208		65

209C			65
210			65
211			65
212			65
213			65
	CATHERINE M. ELDER		
251T			65
252			65
253C			65
254C			65
255			65
256			65
257C			65
258C			65
259			65
260			65
300		65	

P R O C E E D I N G S

JUDGE MACE: Let's be on the record in Docket Number UG-021584. This is the case of Washington Utilities and Transportation Commission against Avista Corporation d/b/a Avista Utilities, and the subject matter of the case is the Avista benchmark proposal as contained in its Tariff Number 163.

We are meeting here today on September 23rd, 2003, at the offices of the Washington Utilities and Transportation Commission in Olympia, Washington. The purpose of our hearing today is to address the settlement agreement that has been proposed by the parties to the proceeding. My name is Theodora Mace, I'm the Administrative Law Judge who has been assigned to hold hearings in this case. With me here on the Bench are Chairwoman Marilyn Showalter and Commissioner Patrick Oshie of the Washington Utilities and Transportation Commission.

I would like to have the appearances of counsel now beginning with the company.

MR. MEYER: Thank you, Your Honor, David Meyer for Avista.

MR. CROMWELL: Robert Cromwell on behalf of Public Counsel.

MR. TROTTER: For the Commission, Donald T.

Trotter, Assistant Attorney General.

JUDGE MACE: Thank you.

I have marked the settlement agreement as Exhibit Number 300 in this proceeding, and later on very shortly counsel will be making a brief presentation of the settlement agreement, and then we will have one of the witnesses, one of the parties present here will describe the settlement agreement.

At this point, I would like to address the Exhibits that were marked at the pre-hearing conference on September 19th. It is my understanding that the parties wish to stipulate those Exhibits into evidence at this time. Is that correct, Mr. Meyer?

MR. MEYER: That is correct.

JUDGE MACE: Let me indicate that the following exhibits are stipulated into evidence. Mr. Norwood's Exhibits 1 through 21, Mr. Gruber's Exhibits 51 through 64, Mr. D'Arienzo's Exhibits 101 through 119, Mr. Hirschkorn's Exhibits 151 through 153. Mr. Parvinen's Exhibits 201 through 213, Ms. Elder's Exhibits 251C through 260. And these exhibits appear and are identified on the exhibit list that will be attached to the transcript.

MR. CROMWELL: Excuse me, Judge Mace, what were the numbers for Mr. Gruber's Exhibits?

JUDGE MACE: They were Exhibits 51 through 64.

MR. CROMWELL: Thank you.

JUDGE MACE: I would like to turn now to counsel for the company, or will it be for Staff, who will present the settlement agreement?

MR. MEYER: I think what I would suggest is that perhaps Mr. Trotter might present the settlement agreement per se. We'll have 15 or 20 minutes through Mr. Norwood of comment describing the proposed mechanism so you know what will be in place at least through March of '05.

JUDGE MACE: Mr. Trotter.

MR. TROTTER: Thank you, Your Honor. The Exhibit 300 is the settlement stipulation. The ones we circulated to you today did not contain the attachment, it was the first page of Exhibit 2. But if you look at the handout, the first page of that is that attachment. We'll make sure our record center gets the appropriate document.

That is the proposed benchmark mechanism overview that I believe Mr. Norwood will be discussing in some detail. The benchmark mechanism has been in effect in some form since 1999. It has never been subject to a hearing as such. The Commission suspended the company's filing of late last year, and this case is that docket to examine the benchmark mechanism.

The mechanism has taken on different forms, although generally consistent but some modifications over time. There's the existing mechanism, the one that's in effect, there is the mechanism that was tariffed by the company and suspended, and then the one that they proposed in their direct testimony, which is again slightly different than what they filed as a tariff, and their tariff filing was suspended. The settlement proposes that what will go into effect on December 1st is the one that they proposed in their direct testimony and defended as their preferred solution with some changes. That's in Exhibit 152 as the agreement says. That's Mr. Hirschkorn sponsored as a description, tariff description, of the mechanism that they are proposing in this docket.

There are a couple of changes to that. The first is the expiration date. The company was asking for a 2007, March 31st, 2007, expiration date, and the parties are agreeing that that can be changed and will be changed to March 31st of 2005. That puts this tariff on par with the tariffs that the company has for mechanisms in Idaho and Oregon.

The next difference, which is described on page 3 of the agreement, has to do with the level of benefits that are shared between Avista Energy, the subsidiary of Avista Corp., and rate payers of Avista Utilities. If you look at the chart, you can see that the company was proposing in the transportation section, and that refers to off-system sales and capacity release transactions, they were guaranteeing $3 Million of benefits and then sharing thereafter 80% to customers, 20% to Avista Energy. If you look at the bottom of that chart, the basin optimization part, there was 80/20 sharing the same as the other component but no guarantee of any specific level of benefits. So what --

MR. MEYER: I'm sorry, and if that is not at this time immediately clear, Mr. Norwood will have some extended comment about how that will all work in his presentation.

MR. TROTTER: So page 3 of the agreement modifies that, and the company is guaranteeing if you pool those two components together --

CHAIRWOMAN SHOWALTER: Wait, which two?

MR. TROTTER: The transportation box and the basin optimization box, and they are guaranteeing if you combine the revenues from those two boxes, it will total $5 Million or Avista Energy will make up the difference. So rate payers will get that much every 12 months guaranteed.

The next $1 Million in benefits from those two pools, if you will, will go 100% to rate payers, and then every dollar above that will go 80/20, 80% customers of Avista Utilities, 20% to Avista Energy. That will require the filing of a new tariff, and the company has committed to do that, and the parties are agreeing that that can be handled on less than statutory notice if required, and it will bear an effective date of December 1 of this year in order to accommodate certain practices and procedures and documentation that the company will have to create to make that work.

The other element of the proposal is that the parties here will agree to engage in good faith discussions regarding gas purchase incentive mechanisms. The goal is that we can come up with a consensus mechanism to present to you for your review and consideration. That effort will go on over the December 1st, 2003, to March 31st, 2005, period, and the parties agree to support that if we reach a consensus. If not, the company agrees that at March 31st, 2005, gas procurement will revert from Avista Utilities back to the utility where it was before September of '99 when the mechanism first went into effect and that they will not file a mechanism of this sort involving an affiliate or a subsidiary to the extent that subsidiary is not an affiliate until after March 31 of 2007. But if they want to file an incentive mechanism involving Avista Utilities itself, that's permitted.

The remaining elements of the settlement, the procedural items and the integration clause and so on, are fairly typical. And if you have any specific questions about those, be glad to answer them, but in terms of the substance of the agreement, in broad form the parties are agreeing that this mechanism can continue fundamentally as proposed by the company with the changes I mentioned through March, the end of March of 2005, and then hopefully we will be bringing you an incentive mechanism of some sort. If not, the company is agreeing to stay -- not to file an affiliate or subsidiary based mechanism for a couple of years beyond that.

And so that's the short explanation of what this agreement does.

JUDGE MACE: Thank you.

What I would like to do now is swear in Mr. Norwood and Mr. Parvinen and Ms. Elder, and then Mr. Norwood could make his presentation, and the Commissioners could ask questions. Is that --

CHAIRWOMAN SHOWALTER: Well, I will just say

I have what I would call a legal or structural question that's not to do with the merits of the new proposal, and so I would actually like to ask that question now just so it doesn't get lost, and it's my primary question.

And it is this, structurally it seems to me that you've got basically plan A and plan B if you call plan A the short-term agreement that you have agreed on, let's call that plan A. If the parties fail to negotiate let's call it plan X, we revert to plan B, that is Avista Utility takes this function back. So it seems to me you are asking this Commission to find in the public interest plan A in the short run and plan B in the long run, and I am wondering how you justify that. There are related questions of whether it is appropriate for one party to be able to veto the ability to do anything. It rests on the assumption that plan B is in the public interest in the future when we are -- you are asking us to find that plan A is in the public interest now.

MR. TROTTER: I will take a first cut at that one. I think you can find that the preexisting arrangement, the pre-September 1999 arrangement when Avista Utilities procured its own gas, is inherently in the public interest because that is how virtually every utility in the country does gas procurement.

CHAIRWOMAN SHOWALTER: If that's the case, why aren't we insisting on plan A now?

MR. TROTTER: Because we have a live issue before us involving a company proposal to keep a benchmark mechanism in effect for another full three and a half years, and that's before you in a litigated context. And so the parties are saying -- the parties are challenging whether the existing mechanism is in the public interest, and what you have before you is an agreement that says, well, as we have, as a package, we are in agreement that it's in the public interest for this mechanism to continue with the modifications that we have suggested until 2005. If we can work out our differences in the meantime and come up with a proposal, that's a good result. But if it doesn't, the utility will revert to what it did prior to the mechanism. I think either of those results can be a mechanism that is a consensus mechanism subject to your approval at that time, could be a public interest result depending on how you evaluate it at that time. Conversely, a gas company that does its own procurement activity I think is almost by default a public interest -- justifies a public interest finding because that is how virtually every company in the country does it.

CHAIRWOMAN SHOWALTER: Well, that reason doesn't strike me as adequate. Supposing two years from now or toward the expiration of this, supposing in fact in reality the Commission, the company, and one of the parties feels that it is in the public interest, but one of the other parties does not.

MR. TROTTER: Think of what is in the public interest?

CHAIRWOMAN SHOWALTER: Whatever the plan A. Supposing things are going well in the eyes of let's say the company, one party, and the Commission, but not in the eyes of another party?

MR. TROTTER: Well, in terms of the mechanism continuing; is that what you're talking about?

CHAIRWOMAN SHOWALTER: Well, no. Why would it be in the public interest if, and why do you wish to bind the Commission to a mechanism that could, let's say plan A could or some other plan, whatever, another plan, that could be preferable, but allow any single party here by veto ability to bind everyone to something that we haven't been doing since 1999?

MR. TROTTER: Well, I think what -- I guess I wouldn't characterize the agreement that way. I think in order for you to make a finding that a particular mechanism is in the public interest would require at least to date, and this docket is the example, would require a hearing, and that's what we have going right now. And so what we have got here is an agreement that this particular mechanism can continue despite the issues that all the parties have with it.

In terms of a veto power, I don't -- I think it's more of the company agreeing that they are not going to file an affiliate-related mechanism for a couple of years after this one expires if they can't reach a consensus, so I'm not sure that's a -- I guess I'm not sure that the Commission would impose, could impose such a mechanism involving an affiliate. I mean that -- it seems like the company can propose one, and the Commission can decide whether it's okay. To date, the Commission has not done that. Conceptually maybe they could. But I think in the context in which this case arises, the company deciding how it will file in the future, that is certainly a decision that the company can make and commit to and the Commission can accept.

CHAIRWOMAN SHOWALTER: I'm not following this. Because supposing we get to the expiration of this current plan, plan A, but there is not agreement among the parties. Okay, at that point, the company can't, the plan A tariff expires, the company can not file for anything for two years, right?

MR. TROTTER: No, they can file -- they agree not to file a mechanism involving an affiliate or a non-affiliate subsidiary for two years, but they can file an Avista Utilities mechanism if they wish.

CHAIRWOMAN SHOWALTER: Or non-affiliate?

MR. TROTTER: Or a third party, non-affiliate, non-subsidiary. For example, they could hire some unaffiliated company to do their gas procurement and file that with the Commission for approval.

CHAIRWOMAN SHOWALTER: All right. But if the company and say all parties and the Commission but one at that moment actually have an opinion that reverting is not preferable compared to other alternatives or to an alternative involving the affiliate, what this agreement says is no one can go forward with that.

MR. TROTTER: That's correct.

CHAIRWOMAN SHOWALTER: Okay.

MR. TROTTER: But I think that the context in which that would occur is highly unlikely.

CHAIRWOMAN SHOWALTER: That's not an issue.

MR. TROTTER: And so I --

CHAIRWOMAN SHOWALTER: All possibilities have to be assumed, because I'm not going to assume that the parties who were not able or with difficulty not very able, you have to assume always all possibilities, one of which is the parties don't agree.

MR. TROTTER: I agree that you should consider that possibility. I would just characterize it as an unlikely one, but I don't deny that you ought to consider it.

CHAIRWOMAN SHOWALTER: Do you think this Commission can on its own motion two years from now decide that it wants to entertain a different alternative?

MR. TROTTER: I think it could on its own motion if there were extraordinary circumstances that justified it.

JUDGE MACE: Commissioner Oshie, did you have anything further?

COMMISSIONER OSHIE: Well, I just wanted to -- if I have anything, it's just to follow the point I believe that the Chairman made, which is I'm having difficulty with the concept, I guess Mr. Trotter and other counsel, that this agreement's in the public interest today as it's currently constructed, but that on April 1st, 2005, it's no longer in the public interest to maintain the mechanism as it now exists. Because just as a function of time, we now find that, you know, that it would no longer be enforceable even though it may be we may believe that this current mechanism serves the interest of the public and the company as well, so.

CHAIRWOMAN SHOWALTER: And as a follow on to that point, there's a distinction between a tariff expiring, which I think is actually a healthy thing because it allows an automatic review of something and you can regard whatever is going on as a pilot or temporary, but the expiration of a tariff does not preclude the Commission from adopting the same thing later or the same thing with variations if that's in the public interest.

MR. TROTTER: This agreement addresses what the company will file or not file at the end of the expiration date. These benchmark mechanism tariffs have all had expiration dates, and some of them have been continued without a finding, an explicit finding that it's in the public interest, they were just allowed to go into effect on occasion of an expiration date had been changed. So this mechanism has had various expiration dates over time without a finding of public interest, and I think what we're doing here is just stating the conditions under which the company would bring this back to you.

And I would invite other counsel to address that issue if they wish.

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: Well, I would concur in the analysis that Mr. Trotter provided. I think the -- it seems that the scenario you are most concerned about is either one where we do not have consensus the day after I guess I should say what would be April 1st, 2005, or somewhere short of that if there was a non-unanimous opinion that the existing mechanism should be continued.

And I think the only thing I would add to the analysis that Mr. Trotter provided is the fact that this agreement does not preclude the company from filing a virtually identical mechanism in terms of what is done in front of this Commission on April 1st. What it precludes the company from doing is having its Avista Energy or some theoretical other subsidiary or affiliate do the work. So in terms of what the work is, there's nothing in this agreement that binds or limits the company from filing a virtually identical agreement on April 1st, it's just that they are agreeing not to have their own affiliate or subsidiary perform that labor.

I think, to the point that the Chairwoman raised, I believe first, as with any settlement, this is a compromise of many different issues. As you have seen in the testimony that was filed on behalf of Commission Staff and on behalf of Public Counsel, we have very strong concerns about a number of different aspects of this mechanism that's before you. Those concerns are not completely addressed by the settlement. All of the company's desires are not completely addressed by the settlement. But as a package as a whole, we are all here before you to support it. A very significant material provision relating to our support of this settlement is the fact that we will have a consensual process during the next 18 months to attempt to develop a mechanism cooperatively that we could all come back before you to support. We don't know whether that will work, but we're all willing to give that a try.

CHAIRWOMAN SHOWALTER: Well, you know, another scenario is the parties can't agree and no party feels that it's best to go back to the pre '99 mechanism, and maybe all parties agree that some kind of benchmark mechanism of some sort is desirable, but you haven't agreed, so therefore we all go back to something nobody wants.

MR. CROMWELL: I think if we were in that situation, I think the company would make a filing that it would deem in its interests, and we would again have a litigated proceeding if that matter were suspended.

CHAIRWOMAN SHOWALTER: A technical question, on page 2, paragraph 5, just the word, it says the benchmark mechanism may continue in the form, do you mean may be implemented?

MR. TROTTER: Yes.

CHAIRWOMAN SHOWALTER: Okay.

JUDGE MACE: At this time, I will swear the witnesses in.

Please stand and raise your right.

(Witnesses Kelly Norwood, Michael Parvinen, and Catherine Elder were sworn in.)

JUDGE MACE: Please be seated.

Mr. Norwood.

Whereupon,

KELLY O. NORWOOD,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

MR. NORWOOD: Yes, thank you. What I would like to do is go through, assuming that the stipulation is approved, the mechanism that will be in place beginning December 1 and continuing through March 31 of 2005. Along with this mechanism, through the mechanism, we have asked Avista Energy to purchase natural gas for our retail customers. Along with that, we have asked them to manage our natural gas storage and the transportation that they have contract rights to to bring the natural gas to our retail customers. Along with that, we have what's called a strategic oversight group that includes employees from Avista Utilities and Avista Energy where they get together on a regular basis and talk about what's going on in the natural gas markets and what Avista Energy is going to do on behalf of customers, so there's that regular communication that takes place to oversee --

JUDGE MACE: Mr. Norwood, can you slow down just a little bit so the reporter can record your words.

JUDGE MACE: Yes, sorry.

With that, we have broken the mechanism down into three components, and I will try to give you in the next 10 or 15 minutes an overview of the whole natural gas purchasing function for the utility, which is a lot there, but we have broken it down into three components. The first, commodity. As you can see on the chart that I have up here, and it's the same chart that you have in front of you, that's marked as Exhibit Number 2. And with those components, you can see the first is commodity. And that commodity component includes -- it's broken down into three tiers, tier 1, tier 2, tier

3.

And I'm going to go into that in a lot of detail in just a minute, so I'm going to go on to the storage component where the company owns one third of Jackson Prairie, and through this mechanism Avista Energy is basically managing it in a way very similar to what Avista Utilities would in that we inject natural gas into storage in the spring and summer and withdraw it during the winter months. Typically the prices during the spring and summer are lower than in the winter time, and so therefore you lock in some prices during that period that are lower than the winter months. What we also do is to the extent you have some cold spells during the winter months, you may also pull more natural gas out of storage to meet the cold spells.

The third component is transportation, and to the extent that we have transportation that's not needed at a point in time to serve our customers' load, then Avista Energy will either release that capacity to another party, or they will purchase gas in one supply basin and move it to another supply basin and capture the differential in the prices between the supply basins. And then basin optimization is another component that I will explain in just a minute.

Going then to what's marked as Exhibit Number

4, which is this chart here, you can see the different tiers or elements of the commodity component. The lower component that you see here is storage, and as you can see, the natural gas that's injected -- well, first of all, if you look at the black line on this chart, that represents Avista Utilities' estimated load for each of the months that you see on the chart, November through October of each year. Prior to the November period, natural gas would have been injected into Jackson Prairie and it would be full. Then we start pulling natural gas out of storage during these winter months to meet a portion of the winter loads, and so that portion of the pricing would be fixed for our customers based on the spring and summer pricing.

The next tier that you see is some fixed price purchases in tier 1, and what the company does here, and again this is based on discussions between Avista Utilities and Avista Energy, we will fix the prices for this portion of the volumes for the 12 month period, which is approximately 50% of the volumes during the period, 6 to 18 months in advance. And the reason for fixing those prices is to provide some level of price stability for our customers so that, for example, in the winter months if prices get very high on a monthly or daily basis, then this level of pricing is already locked in, so that's tier 1.

Tier 2 is another element of the supply where what we have chosen as a company, that being Avista Utilities, is to fix another portion of the pricing on the gas, but it's based on first of month index prices. So prior to rolling into the month, for example in December, we will have fixed the price for the December deliveries for this portion based on the first of the month index price.

So with those two elements then, the tier 1 and tier 2, we will have purchased natural gas prior to going into the month, an amount of natural gas that's equal to the estimated load for the company during that month. But that's the estimated average load for the month, and as we know, as you get into the month, some days are going to be warmer than others, and your loads are going to be higher or lower than the estimate, and that's where the tier 3 component comes in. Whereas you can see on the chart here, Exhibit 4, to the extent that you have, for example, loads that are higher than the monthly average, then Avista Energy would need to either purchase natural gas from the market for that day to cover the load, or they could use storage, purchase storage, or excuse me, pull storage in order to cover that difference. On warmer day, loads might be lower.

Did you have a question?

CHAIRWOMAN SHOWALTER: Yes. Is what defines tier 3 the horizontal line of the graph or the colored bars?

MR. NORWOOD: Tier 3 is actually this line.

CHAIRWOMAN SHOWALTER: Just that --

MR. NORWOOD: The vertical line with arrows, and what that really means is that on any particular day, the actual load is going to be different than what you estimated for the month.

CHAIRWOMAN SHOWALTER: Okay. So the pink bars are a little smaller or a little bigger than estimated there?

MR. NORWOOD: That's correct.

JUDGE MACE: They would turn out to be that, a little bit different?

MR. NORWOOD: That's correct. The pink bar represents the average for the whole month knowing that each day is going to be different.

And what we have done under the mechanism is the costs that are charged to the utility by Avista Energy, if you look at storage, it's going to be the cost of gas that is put into storage based on first of the month prices that occurred in the spring and summer period. For the other tier 1 fixed price purchases, Avista Energy will actually go out and enter into specific transactions to lock in those prices, and they will put those transactions, the documentation, into a file, and they will be there for us to audit and review. The same will be true for the tier 2 component where Avista Energy will lock in the prices at first of month index for this next level, and they will also have those documents available, so it will be the actual transactions on behalf of the utility.

We have not proposed a sharing for the tier 1 or tier 2, because the purpose for that is to lock in the prices, part of them 6 to 18 months ahead of time, the other tier 2 is it's locked in 1 month ahead of time. Where there is a sharing is in this tier 3 balancing. To the extent that the daily loads are higher or lower, what we have done is provided an incentive for Avista Energy to keep those costs as low as possible. So that -- and the way that would be measured is if Avista Energy has to buy gas, additional gas to cover loads because loads are higher, the price charged to Avista Utilities will be their average actual cost from each of the different supply basins that we purchase gas from. And the -- actually, the -- there will be a sharing then.

For example, if the first of the month index price for December is $4 but they have to buy additional gas on a day and it costs $5, that's their average cost from the respective supply basins, there will be an 80/20 sharing on that to where the customers will be bear 80 cents of that difference for those volumes, and Avista Energy will absorb the other 20 cents for those volumes. What they will also do is make a choice based on discussions with the utility as to whether they pull storage to cover that instead of buying from the daily market. And again, there will be an 80/20 sharing based on the economics of pulling storage versus buying in the daily market. And so it's up to them then to keep those costs as low as possible there.

With that, I would like to go back to Exhibit 2.

COMMISSIONER OSHIE: Mr. Norwood.

MR. NORWOOD: Yes.

COMMISSIONER OSHIE: Before you move on.

MR. NORWOOD: Yes.

COMMISSIONER OSHIE: Now is this captured in the agreement, or is this a description of the case that was presented on direct?

MR. NORWOOD: Good question. As Mr. Trotter pointed out, the mechanism that would be in place if the settlement stipulation is approved would be the proposed mechanism that's in our direct case with the one adjustment over here to the $3 Million guarantee goes up to a $5 Million guarantee, plus there's an additional $1 Million that would go to customers at 100% before the 80/20 sharing starts.

JUDGE MACE: Isn't it true --

MR. NORWOOD: So all of this --

JUDGE MACE: Isn't it true also that basin optimization would be pooled with the transportation to create that $5 Million --

MR. NORWOOD: That's correct.

JUDGE MACE: -- mechanism?

MR. NORWOOD: Right.

So the answer to your question is yes. All of this is explained in the testimony.

Back to Exhibit 2 and the storage component. The way that will work is there is a -- actually Avista Energy and Avista Utilities will work together on the timing of storage. And when storage is pulled, there is an 80/20 sharing between Avista Utilities and Avista Energy on any differential between the summer/winter and the summer/winter differential. And in addition, as I mentioned, to the extent storage is pulled on a daily basis to serve load or if there's opportunity at some points to inject more gas into storage as you work your way through the winter, there will also be an 80/20 sharing on that.

For the transportation component, as has already been mentioned, the company had guaranteed in their proposal a $3 Million guarantee and an 80/20 sharing after that, and that is for capacity release and off-system sales. And in the settlement stipulation, as has been said, we have combined the basin optimization and the transportation component so that there would be a total $5 Million guarantee before Avista -- actually it was $5 Million guaranteed where Avista Energy is at risk to supply that if they don't achieve it. And then the additional $1 Million also goes to customers at 100%. So that Avista Energy has to achieve a total of $6 Million on basin optimization and transportation before they start to get their 20% sharing in that.

I think I will stop there and respond to any questions if I can.

CHAIRWOMAN SHOWALTER: I have questions about this possibility of a lack of agreement. Supposing it's about January or February of 2005 and the parties have not reached agreement and so you think you had better prepare for an alternate way to buy gas. If you took the responsibility back within the utility, tell me what you would need to do in terms of hiring people, executing contracts for future periods, that sort of thing.

MR. NORWOOD: We haven't worked out the details as to when the discussions would take place, but my expectation would be that we would not wait too long to get going on those discussions. My hope is that we would get started in the February-March time frame and that we would know in the May, June, July at the latest time frame as to whether we're going to have any kind of consensus around the mechanism. Realistically for us, if we're not able to reach consensus and we choose to bring it back in the utility, we need quite a few months actually in order to hire new people and bring them in, and there would be three to five people that we would need to hire to bring in the utility and bring that function back in.

CHAIRWOMAN SHOWALTER: And how far ahead would you need to be purchasing gas for the post March 2005 period?

MR. NORWOOD: The natural gas year really begins in the November, well, it's really April through March, and right now all the gas has really been purchased for the most part through the March period. So as you think about April kind of starts a new year, and so as we work through next year in the summer months, we will be making sure that we're planning ahead, making the purchases, locking in the gas that we want to to make sure there's a transition there. As we get to the end of March or kind of at the end of the winter period --

CHAIRWOMAN SHOWALTER: Which year are you in now?

MR. NORWOOD: I'm sorry, every March it's basically that way.

CHAIRWOMAN SHOWALTER: All right, but I'm trying to work backwards from March 2005.

MR. NORWOOD: Right.

CHAIRWOMAN SHOWALTER: When will you in a practical sense would you be needing to make purchases for the post March 2005 period?

MR. NORWOOD: Okay. For the tier 1 purchases, which is where you fix the price, they will actually be looking at that in the March-April time frame of '04. They will be starting to look and watch the market. And as you get into the April, May, June, July period, we will be fixing the price for that upcoming winter season. And, in fact, they will be buying gas for that November '04 through October '05 period as early as the April-May time frame.

CHAIRWOMAN SHOWALTER: All right. So under the current, well, let's call it plan A, under that mechanism, Avista Energy around April of '04 would be buying power for the period through March '05?

A. They could be purchasing and fixing the price on gas as early as really the April-May time frame of '04. That could go all the way through October of '05. And those decisions would be made together in the strategic oversight group that I mentioned. Avista Utilities individuals as well as Avista Energy would get together and talk about how much do we lock in, and when do we lock it in, at what price, and those would be specific transactions. So in our view, irrespective of whether the mechanism continues beyond March of '05 or ends in March of '05, those are transactions that we believe should be entered into in any event based on managing the portfolio for our customers.

CHAIRWOMAN SHOWALTER: But if you take let's say the months of April and June '05, who would be making that purchasing decision and how, well, first of all, who would make this decision?

MR. NORWOOD: Right. The tier 1 purchases, and let's assume that this is November of '04, well before you get to March, April, May of '05, we will have already purchased and locked in the tier 1 back here in the middle of '04. And as to who makes those purchases, Avista Energy would execute them, but it's after consulting with Avista Utilities through the strategic oversight group, and they meet regularly to talk about how much do we lock in, when do we lock in, and what is the price when we do it. So it's really a joint thing, Avista Utilities, Avista Energy, especially on the tier 1.

For the tier 2, those purchases also will have already been made, and they would have been made at the first of month index. So you make a choice that I want this portion of my portfolio in April of '05 to be at the monthly index, whatever it is. Part of it's fixed priced ahead of time, part of it will be at the month ahead index, and then whatever the daily differences are will be covered with storage.

CHAIRWOMAN SHOWALTER: Okay. So what is it, what is the function that would be expiring in March of 2005?

MR. NORWOOD: The function --

CHAIRWOMAN SHOWALTER: If the tariff expires --

MR. NORWOOD: Right.

CHAIRWOMAN SHOWALTER: What I'm trying to get at is the transition --

MR. NORWOOD: Yes.

CHAIRWOMAN SHOWALTER: -- from one plan to another, and what I'm trying to understand is would Avista Utilities have to carry out certain functions before March 2005, or not until after 2005 would the Avista Utilities have to say hire people or make purchases?

MR. NORWOOD: Okay, let me tell you what would change then. On commodity, as I mentioned, most of that would already be in place and whether you change it to one place or another. What would change is, apart from hiring people at Avista Utilities ahead of time, would be that beginning in April you no longer would have Avista Energy managing the storage and making decisions on do I pull storage, do I inject into storage. You also do not have Avista Energy buying and selling gas or releasing your transportation. What you would have is someone at the utility now using whatever transport we need to serve load. Whatever the leftovers are, then we would release it to someone else. In the past, we haven't brought a lot of gas to move from one place to another to capture value, so that's probably the major difference is, and that's what we have explained in our testimony, is that Avista Energy moves a lot of gas, and through this mechanism we have relied upon them to optimize the transportation in a way that the utility has not. So what would change is in April of '05 they would no longer be moving gas on our transport for customers. We would be doing that within the utility together with making the decisions within the utility on when to use storage and when not.

Now as we rolled into the next year then into April, May, June of '05, the utility then would be making decisions on what to lock in for the next year into the 05/06 winter.

CHAIRWOMAN SHOWALTER: Thanks.

COMMISSIONER OSHIE: Now this is a question that did or an issue that was raised in the open meeting in which this proposed tariff was suspended, and that issue, Mr. Norwood, is whether or not Avista really is required to have a tariff in place to implement this acquisition strategy or mechanism. And I believe that was the utility's decision, to approach us with, of course, with a tariff as opposed to just implementing the strategy and then coming back to the Commission at a later date and perhaps having to argue the prudency of the purchases that were made on behalf of the utility by Avista Energy. So I'm assuming the question relates back to this agreement is that whether or not the utility would be barred from bringing -- from just implementing the strategy without filing a tariff and just I guess taking the chance, if you will, that the implementation of the strategy would not be challenged by the parties in a prudency proceeding.

MR. NORWOOD: I guess I have two responses to that. One is what we have tried to do through this benchmark mechanism is, number one, comply with the policy statement as best we can, which states that you really should tariff this, and so that's one of the biggest drivers for why it's tariffed. The second response is I guess there's a question in my mind with regard to doing it without a tariff or without some kind of Commission order or accounting order where we would be having this sharing take place on each of the components. Again, I guess that's the question in my mind is could we do that without some kind of Commission order whether it's tariffed or not is the question I guess I have in my mind.

MR. TROTTER: Commissioner, could I give a brief response on that?

We had assumed that the policy statement would be observed, and it does literally require tariffing. We don't think, you know, one of the issues in the case was whether that makes sense in all contexts, but I think until the Commission addresses that in some way, we would expect that they would have to tariff, have to file it as a tariff.

CHAIRWOMAN SHOWALTER: By have to, I haven't read that policy statement recently, but policy statements usually say within them that they are not binding.

MR. TROTTER: Well, this --

CHAIRWOMAN SHOWALTER: Does anyone have a copy of the policy statement?

MR. TROTTER: It is in the record. It's one of Mr. Parvinen's exhibits, and we can take a look at it. But I think that the company did follow the policy statement when they filed it. I think Mr. Norwood makes a correct point that it's likely that an accounting order would be required in any event, but I agree with the concept at least conceptually that a tariff filing would not be required if the company wants to engage in a strategy to buy gas. That normally would not require it.

JUDGE MACE: Mr. Norwood, do you have anything further in your presentation?

MR. NORWOOD: No.

JUDGE MACE: Anything from the other two witnesses?

CHAIRWOMAN SHOWALTER: I have a question for one of the other witnesses.

JUDGE MACE: Go ahead.

CHAIRWOMAN SHOWALTER: I'm not sure which one, but it's not Mr. Norwood I don't think.

And that is, what is the problem with -- why is it objectionable to continue with this until March 2005, see how it goes, have it expire, which would mean that the company would in any event have to propose something, whether it would be the same or different, we would be kind of back to where we are today if it was a contested proposal, maybe they wouldn't, I don't know, maybe they wouldn't have to now that we have just had some discussion about whether they even have to, but the tariff itself would expire, that would be over, what is wrong with that? And I don't even know what witness I'm looking at.

Whereupon,

MICHAEL PARVINEN,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

MR. PARVINEN: I will take a shot at that.

JUDGE MACE: That's Mr. Parvinen for the record.

MR. PARVINEN: Yes. The tariff is I guess kind of a moot point in regards to the settlement. We're talking primarily the benchmark mechanism. So I think regardless of whether it's tariffed or not, we're talking about the mechanism itself.

CHAIRWOMAN SHOWALTER: Well, I guess then same question, if -- is the benchmark mechanism itself part of the tariff?

MR. PARVINEN: Yes.

CHAIRWOMAN SHOWALTER: Then if it expires, doesn't the benchmark mechanism as the mechanism or the approved mechanism also expire?

MR. PARVINEN: Yes.

CHAIRWOMAN SHOWALTER: So then if the tariff expires in March 2005, isn't it essentially then up for argument what prudent activity is, what appropriate benchmark mechanism is, sort of a jump ball in effect?

MR. TROTTER: I will try to answer that. Certainly on March 31st, 2005, if the tariff expires, the gas procurement will revert to the utility. Absent the settlement agreement, they could in theory refile it and tee it up in litigation. I think this is part of the overall package, that the Staff saw very significant issues involving affiliates and gas purchasing and all of that, and so we negotiated this so that we wouldn't face that issue until sometime in 2007 if the company wished to bring it back. But under normal circumstances, when a tariff expires, absent some agreement, under normal circumstances, the company would be able to tee up what it wished at that point, absent some legal constraint.

CHAIRWOMAN SHOWALTER: But this prior discussion about what is and isn't required is interesting, because if March 2005 comes, March 31st, and under the agreement the procurement function reverts to the company, then what does prohibit the company from procuring through its affiliate?

MR. TROTTER: I think as Mr. Norwood indicated, it's the understanding of the policy statement that to do that -- oh, I see what you mean, they could procure without a benchmark mechanism; is that what you mean?

CHAIRWOMAN SHOWALTER: Well, the tariff would go away, the seal of approval of doing this would go away.

MR. TROTTER: They couldn't --

CHAIRWOMAN SHOWALTER: But would anything prohibit at that point the utility from procuring as it deems prudent, whatever that may be?

MR. TROTTER: Well, if they deem it prudent through a benchmark mechanism as defined in your policy statement, I think they would have to file it, and they would have to -- for approval, and they would have to get an accounting order if there's going to be any sharing so that they can do deferred accounting of the sort that is inherent in such proposals. I was thinking of your statement what if they used Avista Energy to procure gas and there was no incentive mechanism at all with that.

CHAIRWOMAN SHOWALTER: Right.

MR. TROTTER: They just hired them, I guess we would have a debate over whether that was an incentive mechanism or not that required filing and deferred accounting. I guess I would have to think that one through.

But I think in general what this agreement does, it says if you're going to follow a benchmark mechanism, I think it's fairly well defined by your policy statement, then if that involves an affiliate, you need to wait until March of '07. If it doesn't, you can file it to be effective April 1 of '05.

JUDGE MACE: Commissioner Oshie, do you have any other questions?

COMMISSIONER OSHIE: No.

CHAIRWOMAN SHOWALTER: Anyone else want to volunteer anything that we haven't discussed?

COMMISSIONER OSHIE: Ms. Elder, you have been quiet, would you like to add something to the record?

Whereupon,

CATHERINE ELDER,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

MS. ELDER: Well, let me add this little thought. You know, the settlement really represents a tradeoff. None of us got, none of us here before you got what we wanted in our heart of hearts or what we put in our prepared direct testimony. But we agreed that with this set of tradeoffs that the company gave something, we gave something, that we felt that it was in the best interests of rate payers to do that agreed thing versus continue to litigate our individual positions. And so I think that's the most important thing as you approach making a decision, that's the most important thing for you to consider.

CHAIRWOMAN SHOWALTER: But you're stating what is true of all agreements.

MS. ELDER: That's true.

CHAIRWOMAN SHOWALTER: You're stating a process statement, the parties agree this is better than litigation. That doesn't get to the merits of what the agreement does or how it plays out.

MS. ELDER: Well, and I think you have to think about the things, the explicit things that we traded off. The company's position would have been, let's put this mechanism in place until '07. We had some concerns about the mechanism, so we can live with it for 18 months assuming that we spend the time to take a second crack at it, see if we can reach agreement on what an appropriate, truly appropriate mechanism would be that we would all agree to. We can at least live with this if we got some additional dollars for rate payers, and that's fundamentally what the settlement achieves, because it gets -- when you adopt an incentive mechanism, essentially what you're doing is you're paying the company extra to hopefully get a better result on gas costs. That's your end goal is to give the company a little extra money to get them to do a better job procuring gas.

And the question is whether or not this mechanism really got enough for rate payers to justify that extra payment. That's your fundamental policy question. And what we're telling you is that we think that given the way that this agreement was put together that we got something that you can say to rate payers, yes, we think it's worth it to pay the 20% to Avista on these other items given that it will be for 18 months, given that we've got the $5 Million plus $1 Million on the transportation and the basis optimization, given that we're going to work together over the next 18 months to see if we can come up with a better mechanism that we're all comfortable with, given all of those things, we think this is reasonable.

CHAIRWOMAN SHOWALTER: But your statement just now seems to me to support plan A expiring on March 31st, 2005, during which the parties try to negotiate something else. I don't see how your statement supports reverting to a different plan on that day and, you know, maybe or maybe not prohibiting one particular sort of benchmark.

MS. ELDER: Well, and we have agreed to not pre-judge that issue and to talk.

CHAIRWOMAN SHOWALTER: But if we -- well, the first thing is I'm not sure what the agreement actually does with respect to the ability of Avista to purchase through Avista Energy after 2005 if there's no agreement. And the reason I'm -- I think the intent is not to allow that, I'm just not entirely certain that's what the effect is. But assuming that's the intent, your statement in support of the settlement doesn't seem to get at that particular issue. It gets at what is the mechanism and tradeoffs between now and 2005, which is more typical of a settlement, to say here's what we're going to do through this next period. It's not so typical to say, and for the following period we're going to do something totally different.

MR. CROMWELL: Well, if I can interject, maybe to use the analogy you used, we're not saying it's a jump ball in March of '05. We're saying it will be a new game. And we don't know --

CHAIRWOMAN SHOWALTER: What does that mean? I'm not a sports --

MR. CROMWELL: Well, I'm sorry, you said jump ball, which is a --

CHAIRWOMAN SHOWALTER: They sound similar to me.

MR. CROMWELL: Well, a jump ball is restarting the ball in play in a basketball game where two very tall men bat it back and forth --

CHAIRWOMAN SHOWALTER: Yes.

MR. CROMWELL: -- to try and get control of it. What I'm saying is that this stipulation that's before you would propose not a jump ball, but rather is starting the clock over, starting a new game. That's different than taking what you've got going and keeping the game going based on what you've got before. What we're all committing to do here is to sit down for 18 months and try and work out the rules of a new game.

CHAIRWOMAN SHOWALTER: Yes, and if you fail to?

MR. CROMWELL: And if we --

CHAIRWOMAN SHOWALTER: Then it's the old game or the old, old game.

MR. CROMWELL: Well, no, actually we don't know what it will be. The company may go back to the old, old game. They may come up with a new game. You know, there certainly are a range of possibilities out there for what they could do.

CHAIRWOMAN SHOWALTER: But do you agree that what at least the intent of the parties was what they can not do, your intent was what they can not do is the current mechanism?

MR. CROMWELL: Our intent is that they not simply refile a mechanism that utilizes Avista Energy, some other affiliate or subsidiary to perform the work. I think something we all do agree on is, (a) the work has to be done, the gas has to flow when people turn the knob on their furnace or their stove; (2) it should be done at the least cost possible that can be done. And we're all interested in serving their rate payers as well as we can, and the only thing that we're debating is how that can best be done. And if it can be best done through an incentive mechanism that creates a motivation for Avista, whether it's through Avista Energy, whether it's through Avista Utilities itself, or whether it's through a third party, to do better than the market if they can do better than the market, then they should be rewarded for doing better than the market.

CHAIRWOMAN SHOWALTER: But can best be done is something that ultimately has to be in the Commission's eyes, but the agreement says if the parties can't agree what is best, then in effect any one party causes reversion to one mode.

MR. CROMWELL: I'm not sure that --

MR. TROTTER: The way that you might -- one might look at this is that the company requested on a March 2000 termination date of their preferred mechanism. And so if they prevailed in this case, that would be what they would get. And what we're doing with the settlement is taking -- is looking at that period of time and telling you what on a consensus basis appears to us to be in the public interest, to keep this mechanism in a slightly modified form for half of that period in essence, and for the other half the utility would manage it if a consensus mechanism isn't developed.

CHAIRWOMAN SHOWALTER: Right.

MR. TROTTER: Or the company could file a non-affiliate related mechanism for your consideration during that time frame.

CHAIRWOMAN SHOWALTER: I find it very anomalous that the parties would agree that an affiliate mechanism is okay for the next two years, but it's not going to be okay if the parties don't agree for the other two years.

MR. TROTTER: Well, I think it's the balance of the negotiations, that there is some change in the mechanism, but that we don't have to battle the affiliate relationship issue until '07 again. But if the company comes up with another mechanism not involving an affiliate, they can file it, and we'll deal with it. It is a very significant issue for some parties, and this is the way we dealt with that as part of the balancing of considerations.

MR. CROMWELL: I think --

JUDGE MACE: Is there any --

MR. CROMWELL: Oh, I'm sorry, go ahead.

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: Yes.

I think the only thing I would add is, and I think the other parties share my feeling on this, is we did want to express our appreciation for Judge Wallis's assistance yesterday. He gave up his day, which I know was not planned, to assist us, and I think it was valuable to us reaching this resolution.

JUDGE MACE: Yes, I certainly appreciated it, and I'm sure the commissioners did too.

Mr. Meyer, did you have anything further?

MR. MEYER: Not on our end.

JUDGE MACE: Great, then the record is, well, this hearing is concluded at this point.

(Hearing adjourned at 4:40 p.m.)