

**BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION  
COMMISSION**

IN THE MATTER OF THE PETITION OF )  
AVISTA CORPORATION, d/b/a AVISTA ) DOCKET NO. UE-06 \_\_\_\_\_  
UTILITIES, FOR CONTINUATION OF )  
THE COMPANY'S ENERGY RECOVERY ) PETITION OF AVISTA  
MECHANISM, WITH CERTAIN ) CORPORATION FOR  
MODIFICATIONS ) CONTINUATION OF THE  
 ) COMPANY'S ENERGY  
 ) RECOVERY MECHANISM, WITH  
 ) CERTAIN MODIFICATIONS  
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1 COMES NOW, Avista Corporation (hereinafter "Avista," the "Utility," or "Company"),  
by and through its undersigned attorneys, and respectfully submits this Petition in the above-  
captioned matter.

2 Pursuant to ordering paragraph 177 of the Commission's Order No. 05, "Approving and  
Adopting Settlement Agreement with Conditions" (Docket No. UE-050482), dated December  
21, 2005, the Commission required Avista to make a filing on or before January 31, 2006 to  
initiate further review of the Energy Recovery Mechanism (ERM)<sup>1</sup>.

3 Communications in reference to this petition should be addressed to the following:

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<sup>1</sup> This will be in lieu of the filing Avista was required to make on or before December 31, 2006, under the terms of the Commission's prior order in Docket No. UE-011595.

## I. INTRODUCTION

4           The purpose of the ERM is to provide for the more timely recovery of power supply related costs, and improve the stability of cash flow and earnings for the Company. This stability is very important to equity investors and lenders, as Mr. Malquist and Ms. Cannell explain in their testimony accompanying this Petition, and is especially important to Avista at the present time for a number of reasons:

5           Avista's heavy reliance on hydroelectric generation as well as its ownership of gas-fired generation results in a significant amount of variability in its power supply operating costs. This variability has been exacerbated in recent years as the wholesale price of electricity and natural gas has risen and become more volatile. Indeed, the Commission, at paragraph 72 in its recent Order No. 05 in Avista's rate case (Docket No. UE-050482), expressly recognized that "[t]he deadband feature of the ERM has subjected the Company to greater earnings volatility than would a more simple mechanism or one with a smaller deadband."

6           The volatility of natural gas prices has created significant variability in the costs to operate Avista's gas-fired generation. The variability of these costs is substantially greater than in the years prior to the 2000/2001 energy crisis when wholesale electric and natural gas prices were much lower and less volatile. Therefore, the ERM is much more important today than it was in the past.

7           In addition to this significant variability in costs, because the Company, the Commission Staff and all other parties to a rate proceeding are unable to accurately predict what future hydroelectric conditions or wholesale market prices will be, it is very difficult to determine an accurate level of power costs to include in base retail rates. To the extent that the power costs in base rates are not set correctly, an effective tracking mechanism, such as the ERM, will make

adjustments so that the Company is able to recover its prudently-incurred costs, and customers will not over-pay or under-pay as these costs fluctuate.

8           The elimination of the deadband as part of the ERM is important to the Company. Repeatedly absorbing the \$9 million deadband every year is undermining the Company's ability to fully regain its financial health.<sup>2</sup> As Mr. Malquist, the Chief Financial Officer of the Company, explains in his testimony, Avista has a significant amount of debt that must be refinanced in late 2007 and in 2008; this is in addition to the need to finance ongoing capital expenditures. It is important to regain an investment grade credit rating in order to refinance the maturing debt and finance capital expenditures at lower interest rates.

9           Increased financial stability, through elimination of the deadband, would be viewed positively by lenders and investors as Avista goes through this period of intensive capital investment. This would enable Avista to attract capital under more reasonable terms, and will be beneficial to customers through lower financing costs over time. Moreover, a financially healthy utility will be better able to withstand difficult financial circumstances in the future.

10           In sum, the elimination of the deadband will help insure further improvement in Avista's financial strength, which will provide long-term benefits to customers through improved access to financing under more reasonable terms. This improvement is consistent with the customers' interests, and is in the public interest.

11           Even with the elimination of the deadband, however, there would continue to be a 90%/10% sharing of all changes in power supply costs under the ERM. Therefore, to the extent the Company has control over certain cost items, it has the incentive to make the most economic choice for the Company and its customers. In addition, the Commission Staff and interested

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<sup>2</sup> Since the ERM was implemented in July 2002, the Company has absorbed \$31.5 million of power costs through the deadband, and an additional \$5.7 through application of the 90%/10% sharing.

parties will continue to perform audits of the Company's performance in its management of power supply costs as part of the annual ERM filings, in order to determine whether costs are prudent and suitable for recovery. This oversight process is an additional incentive for the Company to continue to make prudent choices as it manages its power supply costs.

## II. WITNESSES SPONSORING TESTIMONY ON BEHALF OF AVISTA

12           Mr. Kelly Norwood, Vice President of State and Federal Regulation for Avista, will provide an overview of Avista's request in this filing to continue the existing ERM mechanism, with two proposed modifications, and explain why the Company's proposal is in the public interest. The first modification is to eliminate the \$9 million "deadband," as Avista previously proposed in its March 30, 2005 general rate case filing in Docket No. UE-050482. The second modification is to add transmission revenue and expense components to the ERM calculations. This second modification is in response to recommendations made by Public Counsel in Avista's recently completed general rate case, supra.

13           Ms. Julie Cannell, President of the advisory firm, J.M. Cannell, Inc., is a former securities analyst covering utilities in the energy industry, and former equity portfolio manager with oversight of an equity utility mutual fund, and numerous institutional equity portfolios. Ms. Cannell has been asked by Avista to discuss the perspective of investors with respect to the continued need for the ERM, and the proposed elimination of the \$9 million deadband. She will explain that investors have many choices in where they invest their funds, and for those that choose to invest in the utility industry, the effectiveness of the ERM can make a difference in whether they choose to invest in Avista.

14           Mr. Malyn Malquist, Sr. Vice President and Chief Financial Officer for Avista, will address the importance of the ERM mechanism in the Company's continuing efforts to regain its

financial health, and more specifically to regain an investment grade credit rating. He will explain that, although the ERM has provided improvement in the recovery of power supply costs in recent years, the combination of persistent below-normal hydro-electric conditions for four of the last five years, high natural gas prices, and the existence of the \$9 million annual deadband have continued to undermine the Company's efforts to regain its financial health. Mr. Malquist will explain the importance of both the continuation of the ERM mechanism, and the elimination of the \$9 million deadband.

15           Mr. Ron Peterson, Vice President of Energy Resources for Avista, will provide an overview of the electric resources used by Avista to serve its retail customers. He will explain the significant variability of power costs experienced by Avista due primarily to variations in streamflow for hydroelectric generation, and the variability of wholesale electric and natural gas prices. He will explain why an ERM mechanism is even more important today than it was in the past.

16           Mr. Bill Johnson, Sr. Power Supply Analyst for Avista, will describe the ERM methodology and the Company's proposal to include certain transmission revenues and expenses in the ERM. His testimony and exhibits will also discuss the authorized (or base) level of power supply revenues and expenses used in the monthly ERM deferral calculations.

17           Mr. Ron McKenzie, Manager of Regulatory Accounting for Avista, addresses the accounting associated with the power cost deferrals under the ERM, and the monthly ERM reports that are provided to the Commission and to other interested parties. Mr. McKenzie also provides testimony explaining how the rate used for the Retail Revenue Credit component of the ERM is determined.

### III. EXPEDITED PROCESS

18 Inasmuch as the Commission indicated in its Order No. 05, supra, at para. 77, that it intended to undertake a review of the ERM “at an early date during 2006,” the Company respectfully requests that a prehearing conference be set at the Commission’s earliest convenience for the purpose of developing an expedited hearing schedule.

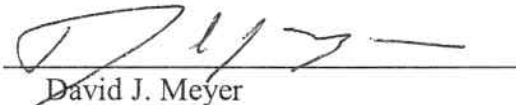
### IV. CONCLUSION

19 Avista respectfully requests that the Commission approve the relief requested in this Petition, including the continuation of the ERM with those modifications identified herein, and as described in the accompanying testimony.

RESPECTFULLY SUBMITTED this 30th day of January, 2006.

AVISTA CORPORATION

By:



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