BEFORE THE WASHINGTON

UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of AVISTA UTILITIES for Extension of The Natural Gas Benchmark Mechanism.	UG-021584 Volume V Pages 110-317

A hearing in the above-entitled matter was held at 9:34 a.m. on Monday, November 24, 2003, at 1300 South Evergreen Park Drive, Southwest, Olympia, Washington, before Administrative Law Judge THEODORA MACE, Chairwoman MARILYN SHOWALTER, Commissioner RICHARD HEMSTAD and Commissioner PATRICK OSHIE.

The parties present were as follows:

AVISTA UTILITIES, by David J. Meyer, General Counsel, East 1411 Mission Avenue, Spokane, Washington 99220.

COMMISSION STAFF, by Donald T. Trotter, Assistant Attorney Genral, 1400 S. Evergreen Park Drive, SW, P.O. Box 40128, Olympia, Washington 98504-0128.

PUBLIC COUNSEL, by Robert Cromwell, Assistant Attorney General, 900 Fourth Avenue, Suite 2000, Seattle, Washington 98164.

Barbara L. Nelson, CCR

Court Reporter

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JUDGE MACE: Let's be on the record in the Matter of the Petition of Avista Utilities for Extension of the Natural Gas Benchmark Mechanism. This is Docket Number UG-021584. Today's date is November 24th, 2003. We are convened in the offices of the Washington Utilities and Transportation Commission in Olympia, Washington. We're scheduled today to begin the evidentiary hearing in this case.

My name is Theo Mace. I've been assigned to hold hearings in this case, and with me on the bench today presiding are Chairwoman Marilyn Showalter and Commissioners Dick Hemstad and Pat Oshie.

I'd like to have the oral appearances of Counsel now, beginning with the Petitioner.

MR. MEYER: Yes, thank you, Your Honor. Will the short form suffice?

JUDGE MACE: Yes, definitely.

MR. MEYER: David Meyer, for Avista Corporation.

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

MR. TROTTER: Donald T. Trotter, Assistant Attorney General, for the Commission.

JUDGE MACE: Thank you. Let me ask if there's anybody on the conference bridge who seeks to enter an appearance this morning? I hear no response.

I believe that we have an order of witnesses calling for Mr. Norwood, Mr. Gruber, Mr. D'Arienzo and Mr. Hirschkorn from the company, and then Mr. Parvinen and Ms. Elder for Staff and Public Counsel respectively. We have Mr. Norwood on the stand and I'll swear him in momentarily. My understanding, from our off-the-record discussion earlier, Mr. Meyer, is that Mr. D'Arienzo is ill today; is that correct?

MR. MEYER: Yes and no. He's very much a game player. He's here, he's in our midst. And he was having trouble with his voice and so forth, so as the day progresses, we'll check in with Mike. And we weren't sure he could even make the trip, to be honest with you, but he is here and we'll just see how well he does. If it appears that he just can't or shouldn't take the stand, if I could have your permission to take him out of order tomorrow, if he's ready tomorrow. Then, if that doesn't happen, we have a backup plan.

JUDGE MACE: It looks like we can address that as the day wears on. You're ready to call Mr. Norwood, then?

MR. MEYER: I am. With that, Your Honor, I call to the stand Mr. Kelly Norwood.

Whereupon,

KELLY O. NORWOOD,

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

JUDGE MACE: Please be seated.

MR. MEYER: Your Honor, it's my understanding, for the record, that the prefiled testimony and exhibits have already been admitted?

JUDGE MACE: That's correct. They were all admitted on the date we had the settlement hearing.

MR. MEYER: Yes. So with that in mind, I can be brief.

D I R E C T E X A M I N A T I O N

BY MR. MEYER:

Q. Mr. Norwood, for the record, please state your name and your employer.

A. My name is Kelly O. Norwood. My employer is Avista Corporation.

Q. And have you prepared and prefiled exhibits that have been already admitted into evidence, exhibits identified and admitted as 1-T, 2, 3-T, 4, 5 and 6?

A. Yes.

MR. MEYER: With that, Your Honor, Mr. Norwood is available for cross.

JUDGE MACE: All right. Mr. Trotter.

MR. TROTTER: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. TROTTER:

Q. Good morning, Mr. Norwood.

A. Good morning, Mr. Trotter.

Q. The benchmark mechanism has been in place since September of 1999; is that correct?

A. Yes.

Q. This case is the first evidentiary hearing the Commission has held on that mechanism; is that right?

A. Yes.

Q. And the Commission has yet to issue an order approving the mechanism; is that correct?

A. I don't recall whether orders were issued in prior decisions or not.

Q. Would you accept, subject to your check, there was not?

A. I'll accept that, subject to check.

Q. Now, your position is there needs to be compelling reasons not to continue the mechanism; is that correct?

A. Yes.

Q. When Avista first filed the benchmark mechanism, it did not tell the Commission that the tariff had to be renewed absent compelling reasons to the contrary, did it?

A. I don't know if we used the word compelling at the time that we filed. There was an understanding that it would be in place for two years and seven months and then be reviewed.

Q. And it was filed as an experiment, was it not?

A. Yes.

Q. On the easel, you have Exhibit 2, page 1; is that correct?

A. Yes.

Q. Okay. I have to admit, I can't read the fine -- even the not-so-fine print from here, but I'm going to refer to that exhibit, and I have it in front of me in hard copy. But this is a graphic depiction of your current proposal that Avista is sponsoring in its testimony today?

A. Yes.

Q. And the magnitude of total gas cost for Avista Utilities is around 76.3 million; is that right?

A. Yes, for this time period and for the Washington jurisdiction.

Q. And -- well, is that an annual figure or is it for the total period January 30, 2004, through March 31st, 2007?

A. There's a footnote at the bottom of the exhibit which indicates it's Washington only for the period April '02 through March of '03.

Q. So it's an annual figure?

A. That's correct.

Q. Do you agree that a benchmark is an objective standard against which the Utility's performance is measured?

A. I believe that, yes, is one definition.

Q. In the benchmark mechanism the company is proposing, the Utility's performance is not measured, but rather the performance of its affiliate, Avista Energy, is measured; is that correct?

A. The benchmark is established against -- the actual costs that are billed to the Utility and that we charge customers is measured against benchmarks, and Avista Energy is the one that's managing it for us, so in that sense, I guess it would be yes.

Q. Let's focus on the commodity part of your Exhibit 2, page one, and that includes Tier 1, 2 -- Tiers 1, 2 and 3; correct?

A. Yes.

Q. I'd like to start with Tier 1 gas. And Tier 1 covers 50 percent of Avista's average monthly gas load that serves its retail gas customers; correct?

A. Yes, approximately 50 percent.

Q. And Tier 1 is based on fixed price purchases of gas that lock in the price of that 50 percent average monthly load; correct?

A. It's that component, as well as some natural gas storage is also a portion of that 50 percent. Tier 1 is fixed price purchases together with storage.

Q. And storage is purchased at fixed price, is it not?

A. Yes.

Q. And those contracts include purchases of gas, including gas and storage, as well as hedges, all of which are entered into specifically for Avista Utilities; correct?

A. That's correct.

Q. And Avista Utilities buys hedges on its own account to assure those prices are fixed; correct?

A. No, in both -- well, in Tier 1, actually Avista Energy is the one that actually executes the hedges to lock in the price for the Utility, and those transactions are done with -- in consultation with the Utility in the Strategic Oversight Group.

Q. But Avista Utilities does not actually enter into the hedges; is that correct? It's AE?

A. It's Avista Energy on behalf of the Utility.

Q. Now, there's no sharing around the contract prices in Tier 1 under the benchmark mechanism; correct?

A. Correct.

Q. And because the price of gas in Tier 1 is fixed, Avista Energy cannot do better than the price reflected in the contracts under Tier 1; is that correct?

A. Correct.

Q. By the same token, Avista Energy cannot do worse than that price reflected in the contracts under Tier 1?

A. That's correct.

Q. So for this 50 percent part of the average retail gas load, there is no benchmark to compare Avista Energy's performance to -- in order to measure

Avista Energy's performance; correct?

A. No, I wouldn't agree with that. There is actually a benchmark. There's no sharing, but there is a benchmark, and that benchmark is the market at the time when the hedges are locked in. And as we lock in these hedges, there will be the actual contract itself, together with other market information as to what the price was at the time, and that would be the benchmark against which we can compare the price that is locked in. We have not proposed a sharing, because it's part of the overall strategy of fixing the price for a portion of the portfolio.

Q. You said you compare something to the price that's locked in. What do you compare to the price that's locked in?

A. We would compare the market prices at the time the price is locked in. There would be broker quotes from a number of marketers or suppliers at the time, and that's what the utility has done in the past and that's what Avista Energy's does, is document the prices available at the time the prices are locked in.

Q. So there is a difference, then, between the market price and the price that's locked in?

A. There should not be. At the time they lock it in, that is the market. And you have broker quotes and other information to demonstrate that that was the market at the time the decision was made.
Q. Okay. So if we're comparing Avista Energy's performance to the benchmark, which you say is the market price, the difference is always zero, isn't it?
A. In this case, it would be zero; that's correct.
Q. And Avista Energy can't outperform the market price in Tier 1, can it?
A. We have not asked Avista Energy to attempt to outperform the market on Tier 1 because it's part of the portfolio of fixing the price on the portion of the portfolio.
Q. My questions are related to the benchmark mechanism as you're proposing it, not as how you might propose it. Do you understand that?
A. Yes.
Q. As the benchmark is currently being proposed, there's no way for Avista Energy to beat the benchmark in Tier 1; is that correct?
A. That's correct.
Q. Please turn to Exhibit 12. This is your

response to Staff Data Request Number 102, and we were focusing on your Exhibit 6, Item Five, where you stated the proposed benchmark mechanism includes a, quote, symmetrical sharing of 80/20 around all components of the mechanism, and then you go on, unquote. Do you see that?

A.   Yes, I do.

Q.   On the next page of the exhibit is a supplement to that data request where we asked you to specify in more detail how Avista Energy shares 80/20 around the gas cost established in Tier 1 of the benchmark mechanism. And you agree, do you not, that there is no sharing around Tier 1?

A.   Yes, I agree.

Q.   And so in your Exhibit 6, when you refer to a symmetrical sharing of 80/20 around all components of the mechanism, you did not mean to include the gas purchases in Tier 1 or Tier 2, for that matter, that account for 100 percent of Avista Utilities' average daily gas needs; is that right?

A.   That's correct.

Q.   Let's then talk about Tier 2, and we'll go back to the chart, Exhibit 2, page 1. And Tier 2 is the other 50 percent of Avista's average gas load for its retail customers; is that right?

A. Yes, that's correct.
Q. And that's purchased at the FOM index, which is the first of the month index price; correct?
A. Yes.
Q. And the FOM index is an actual index reported by various reporting services; correct?
A. That is correct.
Q. And as an index, sellers are supposed to report prices of actual trades, actual prices of actual trades, and it is those actual trades that generate the index price that Avista Energy pays; is that right?
A. I think I'll defer to Mr. Gruber on the actual calculation of the indexes.
Q. Is that your understanding?
A. That's my understanding.
Q. And Avista Energy enters into specific contracts with sellers of gas for that 50 percent of the Avista Energy's average load -- excuse me, Avista Utilities' average load, and those contracts are entered into specifically for Avista Utilities; is that right?
A. Yes.
Q. And under the mechanism, Avista Energy has no discretion to purchase that gas at any price other

than the FOM index; is that correct?
A. That's correct.
Q. And that means that Avista Energy cannot fail to equal the FOM index; is that right?
A. That's correct.
Q. So there is no benchmark for Avista to try to beat in Tier 2, is there?
A. In this case, the benchmark is the index, it is the market, and they're one and the same.
Q. And Avista Energy can't beat it, can it?
A. That's correct.
Q. And likewise, it can't do worse than the FOM index, can it?
A. That's correct.
Q. And like Tier 1, there is no sharing in Tier 2; is that right?
A. That's correct, there's no sharing for Tier 1 or Tier 2.
Q. So looking at Tier 1 and Tier 2 together, 100 percent of Avista Utilities' average gas load has no benchmark that AE, Avista Energy, can either beat or fail to meet; is that correct?
A. No.
Q. That's not correct?
A. No. The Tier 1 is 50 percent of the

estimated load for each of the months. The second Tier 2 is another 50 percent of the estimated load. Once you progress through the months, then it's up to Avista Energy to balance the actual loads with the actual resources, and that's where there will be a difference between the actual prices and what was locked in.

Q. And you're talking about Tier 3, aren't you?

A. That's correct, as well as the basin optimizations.

Q. Maybe it's terminology, but let's -- you have 50 percent Tier 1, 50 percent Tier 2 on your chart; right?

A. That's correct.

Q. Does that represent 100 percent of Avista Utilities' average gas load?

A. That's the estimate; that's correct.

Q. Okay. And for that, 100 percent of Avista's average estimate of its average gas load, there is no benchmark that AE can either beat or fail to meet; is that correct?

A. For those estimates, that's correct.

Q. Okay. And Tier 1 -- oh, excuse me. Let's turn, then, to Tier 3 on the chart, which is still on the commodity component; right?

A. Yes.

Q. And this tier represents gas used to balance Avista Utilities' daily gas loads to the extent the daily loads are above average or below average; correct?

A. That's correct.

Q. And that is because, on a particular day, if Avista's actual load does not equal its average load for that day, Avista Energy has to buy or sell gas for that day in order for Avista Utilities to serve its actual gas loads; correct?

A. Yes.

Q. And Tier 3, the daily purchases and sales, have a benchmark and it is the FOM index; correct?

A. That's correct.

Q. So if Avista buys gas or sells gas in Tier 3 at a price equal to the FOM index, Avista Energy gets no extra benefit, nor do the ratepayers; right?

A. That's correct.

Q. If Avista Energy buys gas at less than the FOM index, it shares the net cost 80 percent to customers and 20 percent to Avista Energy; correct?

A. That's correct.

Q. And on a day in which Avista Energy does not have any transactions, the gas daily index is used to price the gas that's used in Tier 3 that day; correct?

A. Yes, that's on a per supply basin basis.

Q. Now, the gas daily index is an actual reported index, isn't it?

A. Yes, it is.

Q. And is it your understanding that that index is computed by adding up all trades by all traders in the market for that day, they're all added up and averaged and the result is the index?

A. That's my understanding, but again I would defer to Mr. Gruber for the actual calculation.

Q. And over the course of the mechanism as it is actually operated, Avista Energy's daily sales and purchases in Tier 3 have been essentially the same as if Avista Energy had purchased the gas at the gas daily index; is that correct?

A. Yes.

Q. So on average, Avista Energy has not been able to beat the gas daily index price for Tier 3; correct?

A. That's correct.

Q. But by performing at that average level in Tier 3, Avista Energy nonetheless gets paid in Tier 3 if the price it pays or sells at is less than the FOM index for that sale; is that right?

A. Yes.

Q. Would you turn to Exhibit 18, please? And this is your response to Staff Data Request 86. And you explain --

A. Excuse me. Mine shows 122.

Q. I'm sorry.

A. I want to make sure I have the right one.

JUDGE MACE: Exhibit -- let's be off the record.

(Discussion off the record.)

THE WITNESS: Okay. I have it in front of me now. Thank you.

MR. TROTTER: Okay.

CHAIRWOMAN SHOWALTER: Mr. Meyer, would you like a copy of the updated exhibit list?

MR. MEYER: Yeah.

CHAIRWOMAN SHOWALTER: I could do without this for the time being.

MR. MEYER: Appreciate it.

JUDGE MACE: And I apologize if you didn't receive the updated copy. I thought I sent it out.

MR. MEYER: We're all on the same page now. Thank you.

MR. TROTTER: Thank you.

Q. Referring to Exhibit 18, you were asked to explain how, in theory, Avista Energy can beat the benchmark in Tier 3, and we established earlier that that's the FOM index. And at least the first part of your response indicates that Avista Energy does not control the daily index price; is that correct?

A. Yes.

Q. And is it correct in Tier 3 that the only way that Avista Energy can beat the benchmark is to secure a sale or purchase at less than the FOM index; is that right?

A. Yes. Well, there's another way, and that is, in managing storage, we want to incent Avista Energy to make the right decision in terms of pulling from storage to serve load on a daily basis or to buy from the daily market, and so that's why we have an 80/20 around both of those components, for them to get the best deal possible on a daily basis to balance load.

Q. Is the word storage included in your response in Exhibit 18? It is on the last line, isn't it?

A. Yes.

Q. Either through storage or purchase and sales in the market. Thank you.

A. That's correct.

Q. Now, both the FOM index and the gas daily index price is influenced by weather and customer demand for gas, is it not?

A. Among other things, yes.

Q. And Avista Energy doesn't control weather or customer demands for gas on a daily basis, does it?

A. That's correct.

Q. And you indicate that Avista Energy does not control the daily index price, but Avista Energy also does not control the FOM index price, does it?

A. That's correct.

Q. Turn to Exhibit 17, which is your response to Staff Data Request 127.

A. Okay. I have it in front of me.

Q. Okay. And this data request focused on your rebuttal testimony, where you said that there was no undue benefit to Avista Energy under the mechanism. Do you recall that testimony?

A. Yes, I do.

Q. And in understanding your response, am I correct to understand that, in your opinion, so long as the costs and benefits go where the mechanism say they should go, Avista's position is that those costs and benefits cannot be undue?

A. I think there's a combination there. One is, number one, they should go where they're intended to go, and number two, I think they should be reasonable.

Q. So if it turns out that costs or benefits went where they were supposed to, but the result was not reasonable, then it's possible in that circumstance that the benefits or costs could be undue?

A. I think you should take a look at that.

Q. Is that a yes or a no?

A. They should be reviewed and they would be reviewed.

Q. And if they are reviewed and found to be unreasonable, although they went where they were supposed to go, then that would be an undue cost or an undue benefit in that circumstances?

A. That would be a decision for the Commission to make, yes.

Q. Let's go to your rebuttal testimony, Exhibit 3, page 11. Follow up on that point. On line nine, you indicate that, in your view, approval of the benchmark mechanism by the Commission does not constitute pre-approval of natural gas costs and the Commission retains its authority to review and adjust

Avista Utilities' gas cost during a PGA proceeding.
Do you see that?
A. Yes, I do.
Q. So just because this -- in your opinion, just because this mechanism is tariffed and the tariff is followed, the Commission can still look at the reasonableness of the underlying cost and benefits?
A. Yes.
Q. And make adjustments where they deem necessary?
A. Yes.
Q. Your initial testimony, Exhibit 1-T, page seven.
CHAIRWOMAN SHOWALTER: What page?
MR. TROTTER: Seven.
Q. On line 13, you testify that, quote, Through consolidation of the company's gas procurement functions under Avista Energy, Avista Energy has been able to pool Avista Utilities' supply, storage and transportation arrangements with their portfolio. Do you see that?
A. Yes, I do.
Q. And what benefits does that confer on Avista Energy?

A. It -- I think Mr. D'Arienzo mentioned that there is a benefit to Avista Energy in that there is an incremental amount of volume that they do, and I think he mentioned that it's about three percent of their total business and about eight percent of their physical volumes. So it does provide an additional piece to their portfolio, which may provide some -- as Mr. D'Arienzo mentioned, it does provide some benefits. I would have to let him speak to what those benefits are.

Q. I don't want you to defer to someone unless you have to. Let me ask of your own personal knowledge. Are you aware of any benefits that Avista Energy receives by the ability to pool Avista Utilities' supply, storage and transportation arrangements within Avista Energy's portfolio?

A. I guess I would have to let Mr. D'Arienzo speak to that. He's the one that operates that business.

Q. So you don't know if there are any or there are none?

A. I think there are some benefits, but, again, I'd have Mr. D'Arienzo speak to those.

Q. Let's go back to the chart, Exhibit 2, page one, and let's turn to the transportation part or

component of the mechanism. And this part of the mechanism takes into account capacity releases and off-system sales; is that right?
A. Yes.
Q. And Avista is proposing that Avista Energy would guarantee to Avista Utilities $3 million annually in capacity release revenues and off-system sales revenue, and any such revenue above three million would be shared 80 percent to ratepayers and 20 percent to Avista Energy; is that right?
A. Yes.
Q. The mechanism that is currently in effect today guarantees $5 million in capacity release and off-system sales revenues with 50/50 sharing beyond that; right?
A. No. The current mechanism provides the first five million to customers. There's no guarantee with a 50/50 sharing after that.
Q. As the mechanism has operated each year, did the ratepayers, in fact, get $5 million, at least $5 million in capacity release and off-system sales benefits?
A. Mr. Gruber would know the number, but it's my understanding that, in this past operating year, they achieved just a little over $5 million.

Q. As part of the contract between Avista Energy and Avista Utilities that set up the benchmark mechanism, Avista Utilities gave to Avista Energy the right to manage all of the pipeline capacity rights that Avista Utilities has; is that correct?

A. Yes, I believe that's correct.

Q. Now, before Avista Utilities entered into that contract, it had already entered into some long-term contracts in which it had sold a portion of its capacity rights to third parties; correct?

A. Yes, that's my understanding.

Q. And those prior transactions were capacity release transactions?

A. I believe that's correct.

Q. And a capacity release transaction is simply the company selling capacity rights it has on the pipeline to a third party?

A. Yes.

Q. Off-system sales are actual sales of excess gas that Avista Utilities cannot use; is that right?

A. That, or you may choose to buy some gas in one location and move it to another.

Q. Is it correct that the bulk of the capacity release revenue that has come under the mechanism came from capacity release contracts that Avista

Utilities had made prior to the mechanism going into effect?

A. You'd have to ask Mr. Gruber that question. I'm not sure.

Q. Well, let's go to Exhibit 14.

CHAIRWOMAN SHOWALTER: Mr. Trotter, I'm just going to suggest if you could slow your voice down a little bit. It's so hard to hear the question at that pace, so then it's hard to understand what the answer is.

MR. TROTTER: I'll do my best. Thank you.

Q. Please turn to Exhibit 14. And that's --

A. Response to Number 117. I have it.

Q. Okay. And this asked you to provide the annual capacity release revenue between September '99 and February of 2003; is that correct?

A. Yes, it is.

Q. And page two of the exhibit shows the figures for each month of that period; right?

A. Yes, it does.

Q. And would you accept, subject to your check, that the revenues from capacity releases is averaged about 3.7 million a year over the September '99 to February '03 period?

A. Yes, I would accept that. What we have to keep in mind in this case is we're proposing a mechanism to the future, and I'm aware of at least one contract that changes in that future period, so the future dollars won't necessarily be comparable to the past dollars. And Mr. Gruber would have to address that.

Q. Well, Avista proposed a mechanism September '99, did it not?

A. Yes, it did.

Q. And those capacity release contracts, as reflected on this exhibit, were in effect from that period going forward, were they not?

A. I'm not sure if all of these dollars were locked in at that point or whether there was some monthly capacity release that were done. Mr. Gruber was the witness on this, so you would have to ask him what's represented here in these numbers.

Q. Avista Utilities has substantial excess pipeline capacity available in excess of its average load if you take into account pipeline capacity, storage and liquefied natural gas; correct?

A. Again, I believe that's a Mr. Gruber question. He's the manager of gas supply.

Q. Each day, for its entire gas portfolio, Avista Energy has to deliver the results of all of

its purchases and sales using all of the pipeline capacity it has available; correct?
A. I'm sorry, would you repeat the question?
Q. Each day, for its entire gas portfolio, Avista Energy has to deliver the results of all of its purchases and sales using all the pipeline capacity it has available; correct?
A. Are these details for Avista Utilities' pipeline use or their own?
Q. Avista Energy's total portfolio, which would include, would it not, Avista Utilities?
A. I think -- I'm going to have to defer that to Mr. D'Arienzo as to what information's made available daily. It's my understanding that every transaction they do in the pipeline ends up on an invoice, and Avista Utilities -- Avista Utilities actually receives the invoice, which identifies every transaction on the transport.
Q. That's not the question, so I'll ask it of Mr. D'Arienzo. I'd like you to refer to Exhibit 152, which is the tariff, and page 11 of that exhibit.
A. Page 11?
Q. Yes.
A. I have it.
Q. And Item Four talks about -- well, first of

all, this is the proposed tariff, is it not?
A. Yes, it is.
Q. And Item Four on that page talks about the pipeline capacity release and off-system sales. And am I correct that the capacity release transactions are valued on a transaction by transaction basis?
A. Yes.
Q. And under 4-C, for off-system sales, am I correct that the only off-system sales -- that only off-system sales that used Avista Utilities' transportation are valued under the mechanism, as proposed?
A. Yes.
Q. So an off-system sale by Avista Energy that did not use Avista Utilities' transportation would not be credited to Avista Utilities; is that correct?
A. No, as long as it didn't use Avista Utilities' transportation, then that's correct.
Q. Going back to our chart, Exhibit 2, page one, the next component I'd like to discuss is storage. And you refer in that place on your chart to, quote, 100 percent cycle, unquote. Do you see that?
A. Yes, I do.
Q. And that means a full cycle of injections

into storage and withdrawals from storage; correct?
A. Yes.
Q. And is the facility that we're talking about here the Jackson Prairie storage facility?
A. Yes, it is.
Q. The company uses what it calls a, quote, synthetic, unquote, schedule, and that is a schedule that dictates when Avista Energy will inject gas into storage and when it will withdraw gas from storage; correct?
A. Yes.
Q. And generally speaking, it is economical to inject gas into storage in the summer months when prices are lower, and then withdraw gas from storage in the winter months, when gas is more expensive; correct?
A. Yes.
Q. And that price difference is often called the summer-winter differential; correct?
A. Yes.
Q. Under the mechanism, gas that is injected into storage is valued at the FOM index; correct?
A. Yes.
Q. And withdrawals are priced at the average price of the gas inventory that's in storage; is that

right?

A. Yes.

Q. And for purposes of the mechanism, when a withdrawal of gas is made from storage, Avista Energy compares the average inventory price of the gas to the FOM index at the time of withdrawal; correct?

A. I'm sorry, would you repeat the question again?

Q. Under the mechanism, when there is a withdrawal of gas made from storage, Avista Energy compares the average inventory price of that gas to the FOM index; is that correct?

A. Yes.

Q. And if the inventory price is less than the FOM index at the time of withdrawal, Avista Energy gets 20 percent of the differential and Avista Utilities gets 80 percent?

A. Yes.

Q. And to the extent the average inventory price is greater than the FOM index at the time of withdrawal, Avista Energy gets 20 percent of that cost and Avista Utilities gets 80 percent; correct?

A. Yes. Now, that's on the monthly injections and withdrawals. When the storage is done on a daily basis, then there's a different comparison that's done to measure the value of the withdrawal.

Q. Avista Energy does not control the price of gas that comes out of storage in the winter or into storage in the summer, does it?

A. That's correct, although there are decisions -- the injection schedule, the synthetic one, is really established as a guideline, and so there are discussions around the timing of when natural gas is injected into storage.

Q. And who engages in those discussions?

A. That's the Strategic Oversight Group, which would include Mr. Gruber, for Avista Utilities, our risk manager at Avista Utilities, Mr. D'Arienzo, and then there are also accountants and rates folks that periodically attend those meetings.

Q. So the decision would be made by both Avista Energy personnel and Avista Utilities personnel?

A. That's my understanding, yes. Mr. Gruber could elaborate on that more.

Q. You indicated that summer gas prices are typically lower than winter gas prices, and is that the reason why Avista puts gas into storage in the summer and withdrawals it in winter?

A. Yes, although it hasn't turned out to be true this year. The price in the winter is actually lower than in the summer months, so actually, with this mechanism in place, Avista Energy would actually be absorbing a portion of that difference.

Q. But it didn't cause that difference, did it?

A. It's a function of the market.

Q. And it didn't cause that difference, did it, because it's a function of the --

A. It's driven primarily by the market; that's true.

Q. If Avista Energy simply follows the synthetic schedule and gas prices are higher in winter than in summer, Avista Energy gets to keep 20 percent of the price differential on each therm of gas that's withdrawn from storage; correct?

A. Yes.

Q. A true benchmark mechanism would reward Avista Energy only for performance above and beyond what the synthetic schedule generates, wouldn't it?

A. Not necessarily.

Q. Let's go back to our Exhibit 2, page one. I believe the remaining component is basin optimization, and this is the first time this element has been proposed by Avista in any of the versions of the mechanism; correct?

A. It's the first time there's been a proposal to share that element of it.

Q. And it's the first time that the term basin optimization has been used in reference to the benchmark mechanism; correct?

A. I don't recall.

Q. Do you recall specific discussions in prior versions where the basin optimization issue has been addressed, quantified, and stated that the benefits go directly to AE and not AU?

A. I don't recall all the specific discussions that we've had. I know that we've talked about the basin optimization or the price differentials between basins. I --

Q. The three basins are at Sumas -- are called Sumas, Rockies, and AECO, A-E-C-O; correct?

A. Yes.

Q. The mechanism contains certain weightings that prescribe how much of the total gas is assumed to be purchased with each basin for pricing purposes; right?

A. Yes.

Q. Let's turn to Exhibit 152 again, page two. And actually, it may start on page one, but -- I guess we should go to page one. And under the definitions, Item One, it talks about the FOM

weighted average index price, and then later in that paragraph it refers to the index price weighted with a minimum 50 percent AECO, 18 percent Sumas, and 18 percent Rockies; correct?
A. Yes.
Q. And the remaining 14 percent is assigned to one or more of the basins pursuant to a procedure contained in the tariff; correct?
A. Yes.
Q. And the maximum that can -- going over to the next page, the maximum percentage that can be assigned to Sumas or Rockies cannot exceed 25 percent; right?
A. Yes.
Q. And is that due to capacity constraints at those two hubs?
A. It's my understanding it's capacity constraints on a peak day.
Q. And on page two, just reading that first continuing paragraph, with respect to how the 14 percent is spread, it says, The company shall notify the Commission in writing with justification of the assignment of the 14 percent to supply basins on or before January 1st of each year. The Commission shall review the proposed assignment and notify the

company of its decision on or before February 1st of each year. Do you see that?
A. Yes, I do.
Q. First of all, what kind of decision are you contemplating by the Commission? Are you anticipating a hearing and an order, or just what do you have in mind?
A. No, I believe this is more of a notification, as opposed to an expectation that there would be an order of some kind. I believe it's really up to the company to make a decision on what makes the most sense and what is the most economic for our customers, and I think this is more of a notification process.
Q. It says, The Commission shall review and notify the company of its decision. Does the "its" there refer to the company or the Commission? It seems to refer to the Commission to me.
A. I believe that does refer to the Commission. And I think this has -- I may be wrong, but I think this has occurred in the past. I think Mr. Gruber is the one that puts together the letter and notifies the Commission, and I'm not sure what we have received back from the Commission on this.
Q. Okay. And according to this, the weighting

is established by February 1st of each year, but it does not -- it's not effective until October 31st of that year; is that right?

A. I believe it's effective November 1 of the following year -- or actually the current year; that's correct. And the reason for that is you want to establish the percentage so that when you start layering in your Tier 1 purchases, then you know where you need to make those purchases, so it needs to be established ahead of time for the upcoming winter season.

Q. So if a certain basin weighting looks appropriate in February, when it's established, but circumstances change by November, the weightings do not change, do they?

A. That's correct, and you wouldn't -- actually, you wouldn't want to change them.

Q. And the weightings are used to calculate the cost of gas to Avista Utilities' customers; correct?

A. That's the initial calculation, and there are other calculations that would provide benefits if those -- if the prices change between basins, and that's where the basin optimization value comes in.

Q. I'm getting to that. On an actual basis under the mechanism, Avista Energy is not bound to

those weightings in its day-to-day management of the portfolio; correct?
A. That's correct.
Q. And subject to the availability of gas at each basin, Avista can buy as much as it can at the cheapest basin, all else equal?
A. Yes, and you would want them to do that, yes.
Q. And to the extent Avista Energy can access a lower-priced basin to a degree beyond that called for by the basin weightings in the mechanism, that's where we get basin optimization; is that right?
A. Yes.
Q. Until -- there has been no sharing of those basin optimization benefits. Those benefits have all gone to Avista Energy; correct?
A. No direct sharing. Those benefits have gone to Avista Energy to cover the risk that they take on covering the Tier 1 -- actually, the Tier 3 volatility.
Q. And when you proposed the benchmark mechanism in the past, are you telling us that these basin optimization benefits were cited as the reason for -- to justify other portions of the mechanism?
A. It was understood that there was a balancing

that took place. There was an understanding that Avista Energy was absorbing a lot of the risk on that daily volatility, and their compensation for that was the opportunity to capture the basin optimization.
Q. And where was that understanding documented before this Commission, Mr. Norwood?
A. I don't know that it was explicit in any of the filings.
Q. In any event, the mechanism Avista is now proposing would share those benefits 80 percent to ratepayers and 20 percent to Avista Energy?
A. Yes.
Q. Were there compelling reasons for Avista to propose that change, in your opinion?
A. I'm sorry, propose which change?
Q. The change to make the basin optimization a specific expressed component of the mechanism?
A. We actually made that change in response to Staff's desire to capture that basin differential. In doing that, then, we also made an adjustment to the Tier 3, so that you still had a balance of risks and rewards in the mechanism for both the Utility and Avista Energy.
Q. My question was whether, in your view, there was a compelling reason to make that change?

A. We have -- the answer is yes. We have worked hard to try to accommodate Staff's concerns, and that was one occasion where we made a change to try to work out, accommodate that change.

Q. And that issue of basin optimization benefits first arose in Staff's memo urging suspension of the tariff that was filed in this case; is that right?

A. I don't recall when it was first raised.

Q. Okay. Well, there was no sharing of basin optimization benefits in the tariff that you filed to initiate this case, was there?

A. I believe that's correct.

Q. But it is now in the version that you are proposing?

A. Yes, it is.

Q. Please turn to Exhibit 15. This was actually a data request -- well, it's a data request of Avista, but it was responded to by Mr. Gruber, but Item Three asked the company to provide the actual basin optimization benefits achieved by Avista Energy under its agreement with Avista Corp, the Utility. Do you see that?

A. Yes, I do.

Q. And the response refers us to Exhibit

RHG-5-C, which is now Exhibit 55-C; correct?
A. That's correct.
Q. If we could turn to that exhibit, please, 55-C? I'll note for the record this is a confidential exhibit, so I won't be stating specific numbers. Now, the first two lines of data on this exhibit are called forward basin optimization and basin optimization P&L; correct?
A. Yes.
Q. And in the total column, we see the total for those two elements for the period the benchmark mechanism has been in effect, at least through February of '03; correct?
A. Yes.
Q. And if we total those two figures, that would be the total optimization benefits AE obtained over that period?
A. That's my understanding, yes.
Q. Please turn to Exhibit 16. This is your response to Staff Data Request 123. And we asked you to explain your statement on page two of your rebuttal, that the existing mechanism requires Avista Energy to optimize the available transportation and storage assets in a way that reduces the overall costs for Avista Utilities' customers; is that right?

A. Yes.
Q. All of Avista Energy's efforts to maximize price differentials at the basins, other than with respect to the basin percentages expressly called for in the mechanism, inured all to AE's benefit; correct?
A. I'm sorry, would you ask the question again?
Q. Yeah. All of the basin optimization benefits, other than those that would come as a result of the specific basin weightings that were established, inured to Avista Energy, did they not?
A. That's correct, and if you compare that for the past three years, they have actually lost money on that.
Q. Well, let's go back to Exhibit 55, then, 55-C.
A. Yes.
Q. Page one. And can you please -- well, let me ask you this. You told me before that the total basin optimization of benefits achieved by AE since inception of the mechanism through February of '03 is the sum of the two figures on the first two lines of the total column; right?
A. I think we're doing apples and oranges here. Let me clarify my response. 55-C is a backcast of

what would have happened if the proposed mechanism had been in place during this time period. There's another set of information that we provided to Staff which shows what the actual costs were under the actual mechanisms that were in place, and under the actual mechanisms that were in place, Avista Energy retained a basin optimization, as you indicated in your question, but they also absorbed the volatility that occurred in Tier 3 and, on a net basis, they lost money during this time period.

JUDGE MACE: Do you have the exhibit reference for that?

THE WITNESS: It was actually a page in response to a data request to Staff where we provided that.

CHAIRWOMAN SHOWALTER: We might have a bench request for that.

JUDGE MACE: Yes, I'll make a bench request for that information, unless it's already marked as an exhibit that we're not aware of.

MR. TROTTER: Well, I want to go back to Exhibit 15, then.

JUDGE MACE: Well, let's deal with the bench request.

MR. TROTTER: That's fine.

JUDGE MACE: I want to make sure that that information comes into the record.

MR. MEYER: Do you have a reference, Mr. Norwood, to that work paper, so --

THE WITNESS: I may need some help on the data response.

CHAIRWOMAN SHOWALTER: Well, in any event, our Bench Request Number One is simply a backcast of the actual operation that would be comparable to Exhibit 55.

THE WITNESS: Yes.

CHAIRWOMAN SHOWALTER: But not using the new mechanism.

THE WITNESS: Correct.

JUDGE MACE: All right.

Q. I want to go back to Exhibit 15, because I thought that's what we asked for, and you referred us to Exhibit 55. So let's go back to 15, Item Three, the actual basin optimization benefits achieved by Avista Energy under its agency agreement with Avista Corp, the Utility. Do you see that?

A. Yes, I see that.

Q. Okay. Is there anything about that that suggests to you that it's asking for a backcast of hypothetical or whether it's asking for actual? It's asking for actual, isn't it?

A. I'm reading Mr. Gruber's response here. Okay. It's my understanding that the response, the actual calculations that we just talked about were already provided to Staff in response to Data Request Number 5, I think. Three.

Q. Okay. Let me ask this. Exhibit 15, Item Three, we asked for the actual benefits achieved by AE, didn't we, actual?

A. I'm reading the question. Yes, Item Number Three did ask for actual basin optimization benefits; that's correct.

JUDGE MACE: Let's be off the record for just a moment.

(Discussion off the record.)

JUDGE MACE: Let's be back on the record.

Q. I'd like to turn now, Mr. Norwood, to Exhibits 19, 20 and 21. And these are the quarterly reports or excerpts of quarterly reports that you submitted on behalf of -- or the company submitted regarding the benchmark mechanism. And I'd like to refer you first to Exhibit 19, the second page. And this is a report for the quarter ended December 31, 2002; correct?

A. Yes.

Q. And I'm looking under Item Seven. Am I correct, under the total there, that there was a loss related to storage benefits under the mechanism, a loss to customers of approximately $908,000?

A. I see that, yes.

Q. And in Exhibit 20, which is a similar report for the quarter ended March 31st, 2003, shows a loss of around $716,000 for storage. Do you see that?

A. Yes, I do. I'd like to point out that I'm not that familiar with these reports, so I guess I would need to make sure that Mr. Gruber would agree that that's what that represents here on this page.

Q. Okay. Then go to Exhibit 21. The same second page shows a loss in the storage area of -- this is the report for the quarter ended June 30, '03 -- of around 160,000. Do you see that?

A. Yes, I see that.

Q. Okay. My question to you is did any member of the strategic oversight committee discuss with you these specific losses and how the mechanism could be used to address them?

A. No.

Q. Did these --

A. And I'm not a member of the Strategic Oversight Group.

Q. I understand that. Did these losses result in any changes to the mechanism or how it was operated, to your knowledge?
A. I'm sorry, would you ask the question again?
Q. Did those losses cause any changes to how the mechanism was operated, to your knowledge?
A. I don't know.
Q. I'd now like to turn to the Integrated Resource Plans, which are excerpted in Exhibits 22, 23 and 24.
MR. TROTTER: Your Honor, I spoke with you off the record at the beginning of the hearing. I will ask for official notice to be taken of the complete report. It's purely for minimizing copying costs, but also to allow parties to refer to the entire document if they wish.
JUDGE MACE: And you have copies of the complete report for the Commissioners?
MR. TROTTER: I have three of each and I can make more. I just couldn't get all the copying done. So if the Commissioners want it now, I can hand it up. I know Mr. Norwood has a copy and the other parties do. Why don't we just go through the cross and if the need arises, I'd be happy to --
JUDGE MACE: Is there any objection to

taking official notice of the entire documents? I believe that's -- oh, let me see here, the 1997 IRP, then the 2000 IRP, and the 2003 IRP. If there's no objection and the Commissioners have no problem with it, I'll take notice of those documents at this time, but we have these excerpts for cross-examination right now.

MR. TROTTER: Okay. I would note for the record the 2003, I think it shows on the second page, but it is still in draft, but the other two were final.

Q. My question, Mr. Norwood, is looking at Exhibit 22, the 1997 Integrated Resource Plan of the company, that was the last plan filed before the benchmark mechanism was implemented; is that right?

A. Yes.

Q. And turn to page -- what is marked in the -- it's the upper left -- six. It's the third page of the document, as part of the summary, and in the first paragraph after the bulleted text there, the company talks about its diversified portfolio strategy. Do you see that?

A. Yes, I do.

Q. And it indicates that the --

JUDGE MACE: I'm sorry, can you tell me

again where you are?

MR. TROTTER: Third page of the document, it has a six in the upper left-hand corner.

JUDGE MACE: And which paragraph?

MR. TROTTER: It's the third paragraph, excluding the bulleted piece.

CHAIRWOMAN SHOWALTER: Beginning with what?

MR. TROTTER: The company's diversified portfolio strategy.

JUDGE MACE: It's in the left-hand column.

MR. TROTTER: Yes.

JUDGE MACE: Thank you.

Q. Assumes that WWP can take advantage of competition between three major production areas, as well as general cycles in natural gas pricing. Do you see that?

A. Yes, I do.

Q. And the three major production areas are the three basins we've been talking about?

A. Yes.

Q. So before the mechanism was in place, the company was already taking advantage of competition between the three basins?

A. Yes, that's correct.

Q. Next I'd refer you to page C-7 in the upper right-hand corner, and this is part of the supply side resources section of the IRP. And here you begin a discussion of capacity releases, and on the following page, off-system sales are discussed; is that right?

A. Yes.

Q. I'd like to focus on the charts on page C8 and C9. C8 shows capacity release total system for the years 1993 through '96; correct?

A. Yes.

Q. And would these figures be for the company's Washington and Idaho service areas?

A. I believe that's correct.

Q. So would it be fair to say that the level of -- well, let's go to the -- excuse me. Go to the next page, C9. It shows off-system sales for the same period.

A. I'm sorry, did you see a reference someplace where this would exclude the Oregon properties? I don't see it here, and I'm not certain whether it's just solely Washington and Idaho.

Q. Okay. Yes, if you go to page C5, where this section starts, it says Washington/Idaho.

A. Thank you.

Q. So we were on page C9, the off-system sales total system. Would it be fair to say that capacity release revenues were expanding rapidly prior to the benchmark mechanism going into effect?

A. For these years, yes.

Q. And off-system sales ranged around five to 13 million prior to the mechanism going into effect; is that right?

A. Yes, for these time periods.

Q. And Avista Utilities achieved those levels without Avista Energy, did it not?

A. Yes. We have to be careful about using the past to predict the future, though, obviously.

Q. Turn to the last page of the exhibit, which is page C10. I'd like to focus on the discussion under incentive mechanisms in the right-hand side of the page.

MR. MEYER: I'm sorry, Counsel, what page?

MR. TROTTER: The last page.

MR. MEYER: Thank you.

Q. C10. And it says, in the last paragraph. under incentive mechanisms, about halfway through, The challenge is to come up with fair benchmarks which can measure cost deviations resulting from decisions and actions over which the company has some control. The company believes it should be rewarded or penalized on its decisions, not simply because the market trends up or down, unquote. Do you see that?

A. Yes, I do.

Q. Is that a current correct statement of company policy?

A. I believe the essence of the mechanism we have before you is consistent with this.

Q. That wasn't the question. The question was whether the statement that I quoted is a current statement of company policy?

A. I guess I would have to spend time looking at this in detail to know whether we would modify this in any way.

JUDGE MACE: Mr. Trotter, I'm not sure where you are in your cross, but it seems like it might be time for us to take a break at this point.

MR. TROTTER: Yeah, I think I probably have about 15, 10 to 15 minutes more.

JUDGE MACE: Let's take a 15-minutes recess.

(Recess taken.)

JUDGE MACE: Mr. Trotter.

MR. MEYER: Excuse me. Before we get started, there was a matter of Bench Request Number One.

JUDGE MACE: Correct.

MR. MEYER: We think we have materials here that were responsive to Data Request Number 3, that -- an excerpt from that that would be responsive to your bench request. It contains a sheet, it shows Avista Energy's P&L as you go back in time as the mechanism did operate. We'd like to make that available. Perhaps during the lunch hour we could make confidential copies of that. We want to treat that as a confidential exhibit.

And then my concern is, rather than just send it in after the hearing's closed and you don't have an opportunity to ask questions about it, if we could have that done right after lunch, if Mr. Norwood's on the stand, but more importantly, Mr. D'Arienzo, with Avista Energy, probably would be in a better position to respond to questions on that bench request. Is that satisfactory?

JUDGE MACE: I think that would be very helpful.

MR. TROTTER: Your Honor, that information was not supplied under a confidentiality stamp earlier, data request --

MR. MEYER: I think we would like to provide that on a confidential basis.

MR. TROTTER: We'll have to re-mark all of our copies, then.

MR. MEYER: But you haven't -- I'm sorry. I'll work it out with Mr. Trotter over the break.

JUDGE MACE: If you two would talk about it, and then we can address it again when you --

MR. MEYER: Sure.

JUDGE MACE: -- present it to us.

MR. TROTTER: Thank you.

Q. I'd like to resume -- turn your attention to Exhibit 23, the 2000 natural gas IRP excerpts.

A. Yes.

Q. Am I correct that this would be the first IRP issued since the benchmark mechanism went into effect?

A. Yes.

Q. Please turn to page C5. Focusing on the first new paragraph, about halfway down, there's a reference to the company combining customer loads in Idaho, Oregon, and Washington to increase its operational flexibility, and this results in a portfolio that serves a larger portion of the demand with spot market supplies while serving projected non-coincident peak demands with firm supply contracts. Do you see that?

A. Yes, I do.

Q. Is one conclusion one can take from this that Avista combines loads in its three major jurisdictions and buys gas on a total portfolio basis for those three jurisdictions to achieve operating efficiencies?

A. Yes, you need to talk to Mr. Gruber on details, but yes, we do combine some of the loads, at least, to gain some efficiencies.

Q. In each state, Idaho, Oregon, and Washington, gas cost is calculated under the terms of the benchmark mechanism in effect in each state; is that right?

A. Yes.

Q. Let's turn over to page G4, and this is -- starts on G3, the action plan component of the 2000 IRP, and page G4, Roman numeral III, has action items associated with supply and capacity. Do you see that?

A. Yes, I do.

Q. And they continue over, there's four items, the fourth is on page G5; is that right?

A. Yes.

Q. And each of those action items, in general, is -- rather than reading each one out loud, but they're different ways in which the company can be more cost effective for benefit of its customers, and these are four items that the company has included in its action plan to take action on; is that right?

A. Yes.

Q. In each instance, the company states, quote, through the benchmarking arrangement with Avista Energy, this function has been achieved. Do you see that?

A. Yes, I do.

Q. Would you accept, subject to your check, that nowhere in this IRP is there any quantification as to how the particular action item has been achieved by the benchmarking arrangement with Avista Energy?

A. I'll accept it subject to check.

Q. Now, let's turn to Exhibit 24, which is the 2003 natural gas IRP, correct, excerpts?

A. Yes.

Q. And this is still in the draft stage; is that right?

A. Yes.

Q. And that's shown on the second page of the exhibit, G1, draft?

A. Yes, and I'm not sure if it's been finalized at this point.

Q. Okay. Go to page G2, the third page of the exhibit, and part of -- this is just a table of contents, and part of the IRP is the action plan review. Do you see that?

A. Yes, I do.

Q. Let's go to page G3, where the action plan review begins, and actually the following page, G4. For the supply and capacity action plan items from the prior IRP that we just discussed, Exhibit 23, this is the -- in Roman Numeral III on page G4 is the company's action plan review for that part of the prior plan; correct?

A. I'm sorry, would you repeat the question?

Q. I'd better. Thank you. Page G4 of Exhibit 24, in Roman numeral III is the action plan review for supply capacity issues; correct?

A. Yes.

Q. Now, the prior plan that we discussed, 2000 IRP, had four action items in it. Do you recall that?

A. Yes.

Q. In the 2003 IRP, we see one entry for supply capacity; correct?

A. Yes.

MR. TROTTER: Your Honor, I don't believe

I've -- that 22, 23 and 24 have been admitted, so I'll offer them at this time.
JUDGE MACE: Any objection to the admission of these proposed exhibits?
MR. MEYER: No objection.
JUDGE MACE: I'll admit them.
MR. TROTTER: Those are all the questions at this time.
JUDGE MACE: Thank you. Mr. Cromwell.
MR. CROMWELL: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. CROMWELL:
Q. Good morning, Mr. Norwood.
A. Good morning.
Q. My name's Robert Cromwell, Public Counsel section of the Washington State Attorney General's Office. Do you need a break? Are you all right?
A. No, I'm fine. Thank you.
Q. Your discussion with Mr. Trotter covered many of the items I was intending to cover, so I will try to shorten the time estimate we discussed earlier. Could we please turn to your direct testimony at page four?
A. Okay.

Q. And if we look at line three in that paragraph that begins there, you state that the mechanism provides an objective determination of gas costs; correct?

A. Yes, I do.

Q. And there are other ways that a mechanism could be structured. That's also true; correct?

A. Yes.

Q. And if we go down to page 12, if you look down at the numbered items beginning at line 13 through 19, you discuss how the commodity component of the proposed mechanism contains the -- you discuss there that the three elements are tiers; correct?

A. Yes.

Q. And the Tier 1 fixed price purchases are essentially forward contracts for gas; correct?

A. Together with storage, yes.

Q. And as you discussed with Mr. Trotter, there is no particular management expertise exercised in entering into forward contracts; correct?

A. No, I wouldn't agree with that at all. There's a lot of work that goes into both the timing, as well as the counter-parties in the specific contracts that you would enter into in Tier 1, as well as the storage transactions.

Q. And in that regard, can you detail for me the specific nature of the management expertise which Mr. D'Arienzo would exercise for Avista Energy, which Mr. Gruber would be unable to exercise for Avista Utilities?

A. I think I'll defer that to Mr. Gruber. That way, you're talking to the person that's actually managing the Utility business, as well as Mr. D'Arienzo, who operates and runs the gas business on behalf of Avista Energy.

Q. The Tier 2 forward purchases are made at the first of the month index price; correct?

A. Yes.

Q. And regarding the management expertise in exercising or making first of month purchases, is your answer the same?

A. Yes.

Q. And with regard to Tier 3 daily load balancing purchases, are your answers the same?

A. Yes.

Q. Isn't it true, if we go to page 13, lines nine through 13 -- are you with me?

A. Yes.

Q. Isn't it true that there you say that the cost of Avista Utility making daily purchases is essentially the same as it would be under Avista Energy under the proposed mechanism?

A. Yes, for those Tier 3 transactions.

Q. Thank you.

A. What you also have to keep in mind is the management of storage together with the purchases or sales in the market, so there's some decision-making that goes on there.

Q. Thank you. I'd like you now to turn to Exhibit 3, which is your rebuttal testimony, at page four. And if you'd look at lines seven through 16, please. Let me know when you're there.

A. Which page? I'm sorry.

Q. It's page four of your KON-3-T --

A. I'm there.

Q. -- which has been admitted as Exhibit 3.

A. I'm there.

Q. You state that the mechanism is symmetrical, and therefore customers and Avista Energy are treated equally; correct?

A. I'm not sure if I would agree with that. What I said is that there's a symmetrical sharing incentive that's in place for the elements of the commodity portion, the storage, and the transportation, as well as the basin optimization so

that Avista Energy has the same incentive across all of the components to make the right decision for Avista Utilities.
Q. All right. Let me put it a bit differently. Would you agree that symmetry would only work when there is an equal risk of reward and loss?
A. I think there should be an equal -- or at least a balance of reward and loss across the whole mechanism. There may be different elements where it may be difficult to have a sharing that's compared to others, but across the mechanism, there should be a balancing of the risks and rewards.
Q. All right. So therefore, for example, if the chance of beating the proposed mechanism versus not beating it were 50/50 or equal, then symmetrical sharing would be appropriate in that circumstance or hypothetical; correct?
A. I'm sorry, I didn't follow the question.
Q. Well, let's step back. If you flip a coin, statistically, there's a 50/50 probability of getting one outcome or the other.
A. Sure.
Q. And similarly, if a mechanism were structured so that the opportunity to beat it or not beat it were equal, or 50/50, then, again,

theoretically, if you were to make the sharing symmetrical, that sharing would occur 50/50, proportionate with the probability of gain or loss?

A. Again, it goes back to looking at the total mechanism, all the components to make sure there's a balancing. I don't believe you can take one component, for example, of the Tier 1 that we were talking about. There is no sharing around that, and there's no sharing for a reason. The purpose of that one element is to fix the price on that. If you start talking about a sharing, then it unwinds the objective of fixing the price, so there are certain elements where it may not make sense to have a sharing, but on balance, when you look across the whole mechanism, there should be a balancing of risks and rewards, and I think there is here.

Q. Well, let me put it a different way. If the probability of beating the proposed mechanism or receiving rewards under it is greater than the probability of not beating it, i.e., incurring a loss, this would result in an asymmetry, would it not?

A. There could be situations where that would be true.

Q. So would you agree with me that aligning

Avista Energy and Avista Utilities' customers' interests entails sharing the risks of gain and loss equally?
A. Yes, and that's what's embedded with the 80/20 sharing across all of the components. Avista Energy doesn't have an incentive to favor one component versus the other. They're equally incented with that 80/20 sharing.
Q. So then you'd agree with me that simply having equal sharing percentages would not necessarily mean that there would be an equal risk of reward or loss?
A. I'm sorry, I may have to have you repeat that question.
Q. Okay. Assume that we have equal sharing percentages. Do you have that in your mind?
A. Yes.
Q. Great. Would you agree with me that that does not necessarily mean that there is equal risk of gain or loss?
A. That could be true in some instances, yes.
Q. Okay. Well, let's talk about a hypothetical. Let's assume for a moment that on a specific element the probability of beating the mechanism or receiving a reward was 90 percent. In

that circumstance, gains would be virtually assured over a long term, would they not?

A. Yes.

Q. And if the chance of beating a proposed mechanism were 90 percent, why should shareholders receive 20 percent of the gains when they have little chance of experiencing 20 percent of the virtually nonexistent losses?

A. Again, you can't just look at one element and say that the element is inappropriate because there's no sharing or else there's a higher probability of gains. Let me give you an example. Tier 3 is covering the daily load variability. And if you look at the numbers for the past four years, that is a net cost, and so in your example of 90/10, there's at least a 90 percent probability that over time that is going to cost Avista Energy money, and they recognize that. We recognize that. That's part of the package.

There are other elements of the mechanism where there's a higher probability that they will make some money on that. And so you have to look at all the pieces and balance them out and see, on average, then, what is the expectation of benefit to Avista Energy and to Utility customers. And all the analysis that we've done shows, on average, Avista Energy is expected to make about a million dollars per year and Avista Utilities' customers about 2.6 million per year. Now, the different elements are going to work differently.

Q. All right. I'd like to return to the hypothetical I gave you before. Do you still have that in your mind?

A. Yes.

Q. Isn't it true that, in that scenario, symmetrical sharing would be unfair, because the company would be virtually guaranteed the 20 percent gain while being rarely exposed to the 20 percent loss?

A. No, I don't agree.

Q. Would you agree, then, that the goal of symmetrical sharing is to create equal exposure to gains and losses and not simply share an equal percentage of gains and losses?

A. I think the goal, if you look at the policy statement and if you look at incentive mechanisms in general, the objective is to design something that provides benefits to both parties, that provides the incentives in the right place so that decisions will be made to gain benefits. And obviously, in a business like this that's fairly complex, it's not as simple as just saying I want to apply this percentage to everything in every element and assume that everything works out right. We've done a lot of analysis around designing this and it's been refined over the past four years to get to the point to where I think, on balance, there's a reasonable sharing between the parties.

Q. Well, let's look at some of the specifics. With regard to storage, as you discussed earlier with Mr. Trotter, isn't it true that the proposed mechanism does not create equal exposure to gains and losses associated with storage, but rather simply allocates the resulting gains or losses equally?

A. With the storage, storage is used for both the summer-winter differential, as we talked about, as well as daily transactions to cover spikes in loads or, if loads are off, maybe you can inject gas on a daily basis in the storage. By having an 80/20 sharing apply to that element, as well as the other components, it provides the right incentive for Avista Energy to make the right decision on a daily basis or a monthly basis with regard to storage. And you can look at the summer-winter and say, Well, how much control do they have over that, and do they have a lot of control? No. But it provides that right incentive for them to make the right choices around the whole of storage.

And as I mentioned with Tier 3, they have exposure there which goes the other way, and you have to look at the magnitude of the dollars in both cases to ensure that there's a balance there, and we've done that.

Q. I understand your wholistic view, if I may, but my question was specific to storage. And again, I'll ask you whether or not you believe it's true that, as to storage, the mechanism that your company is proposing does not create equal exposure to gains and losses, but rather simply allocates the resulting gain or loss equally?

A. I guess I'd have to look at -- I'm not sure I agree with that. And the reason is if you look at this year --in the past, the expectation is that summer prices are lower than winter prices, but if you look at the last several years, the last four years, my understanding is two -- in two occasions, winter prices have been lower than summer prices, which -- and that's the case this year. We're seeing now that winter prices are lower than summer, which means that Avista Energy is absorbing 20 percent instead of gaining 20 percent. So I can't sit here and tell you that, to the future, there isn't an equal probability of that sharing. They're absorbing the cost this year and we hope that there will be a better differential in winters to come, in which case then they would gain in that.

Q. Well, as to seasonal differentials and pricing, isn't it true that Avista Energy exercises no market expertise; it's simply responding to the market prices that exist?

A. No, I don't agree, and I would encourage you to talk to Mr. Gruber and Mr. D'Arienzo as to how they manage storage and the process they go through in terms of the timing of putting gas in the storage, as well as pulling gas out of storage. I'm trying to think of the right word. The synthetic schedule is a guideline, and the Strategic Oversight Group makes decisions around the timing and quantities of volumes that go into storage.

Q. So are you saying that the Strategic Oversight Group makes decisions that affect the summer or winter market prices?

A. I would defer that to Mr. Gruber and Mr. D'Arienzo. They are the ones that actually manage it, and they can give you an answer to that.

Q. All right. Looking again at Exhibit 3, turning to page six, at the top of the page you're discussing basin optimization and daily storage management; correct?
A. Top of page six?
Q. Yes, page six of your rebuttal testimony, KON-3-T, which has been admitted, I believe, as Exhibit 3?
A. Yes, I see that.
Q. And here again, Avista Energy would essentially receive 20 percent of the benefits that result from basin optimization and daily storage management; correct?
A. Yes.
Q. And is it your understanding that Avista Utilities would also perform these same functions if Avista Utilities were responsible for managing the gas portfolio?
A. Yes, they would, but I don't believe that the value that the Utility would generate would be anything close to what Avista Energy can achieve for the Utility. And that's the point with the mechanism.
Q. On page 17 of your rebuttal testimony, you discuss the Commission Staff's second and third

alternative recommendations; correct?

A. Yes.

Q. And your conclusion is that those proposals would shift risk to Avista Energy and benefits to Avista Utilities in a manner that you conclude to be inappropriate; correct?

A. Yes.

Q. Would you agree that ultimately that decision is a matter of judgment for this Commission to determine?

A. I think that's ultimately a decision that Avista Energy would make. The reality is, in talking with Avista Energy, that they would not do the deal under alternatives two and three, because it simply isn't economic.

Q. So just so I understand, your understanding of Avista Energy's position is if, hypothetically, this Commission conditioned approval of a benchmark mechanism upon adoption of Commission Staff's alternatives, that Avista Energy would not -- well, I suppose it would essentially exercise some right of rescission or refusal to engage in providing that service for Avista Utility?

A. It is not economic for Avista Energy, and we would not go forward. You need to talk to Mike

D'Arienzo, and he can speak to that.

Q. Okay. I'd like you to turn now to Exhibit 6, which is also KOM-6? And do you, by any chance, also have a copy of Exhibit 210, which is the Commission's policy statement?

A. I do have a copy of it.

Q. All right. And you may want to have those handy together. Let me know when you're ready.

A. I'm ready.

CHAIRWOMAN SHOWALTER: What was the second one?

MR. CROMWELL: It's Exhibit 210. It was Mr. Parvinen's 10.

JUDGE MACE: 210.

MR. CROMWELL: Yeah, it's been admitted as Exhibit 210.

CHAIRWOMAN SHOWALTER: Got it.

MR. CROMWELL: It was Exhibit 10 to his testimony.

Q. And it's your position, is it not, Mr. Norwood, that the company's proposed mechanism comports with this policy statement?

A. Yes.

Q. And if we look at Policy Number Four, the Commission states that the proposed mechanism should reflect the market and the company should be rewarded when its performance is better than the market; is that correct?

A. I guess I'd like to read what it says from the Policy Statement Number Four, just to make sure that we're clear. The gas commodity portion of incentive mechanisms should judge performance against a benchmark for gas cost based on market prices, not an LDC's historic cost. Using an external benchmark for the commodity portion will provide LDCs with incentive to perform better than the market.

And in this case, what we have is we have benchmarks for all of the components, we have a sharing around Tier 3, which -- where there is a comparison of the actual cost to the benchmark established, which is the first of month index. You also have a benchmark or a sharing around the basin optimization.

So I don't see -- I mean, the mechanism is consistent in that it has a benchmark to compare against and a sharing against it.

Q. Okay. Well, let's break it down. Is it your reading of Number Four, and I'll focus on the second sentence, first, that the Commission seeks an external benchmark?

A. Yes.

Q. And second, that it seeks to incent performance that is better than the market?

A. Yes.

Q. Would you agree that this implies that simple changes in the market should not result in benefits?

A. Not necessarily. We -- with this whole mechanism, and if you look at this policy statement, I think overall the policy statement, even though it was done about six years ago, is still pretty good in terms of trying to develop a mechanism that does the right things. And I think the sharing and the benchmarks we have are very effective in accomplishing even this Number Four.

Q. I guess my question to you, then, going back to Number Four, in your reading of Number Four, do you reach the conclusion that changes in the market that are external to any exercise of discretion or management expertise by Avista Energy or Avista Utilities should create rewards to the company, yes or no?

A. Yes, it can. And in cases, it's appropriate, because in some cases it's hard to distinguish between the differences that are caused by decisions made and differences caused by the market. And in putting together the commodity portfolio, you have the Tier 1 and Tier 2 transactions, which provide some fixed pricing, some ahead of time and some of it a month ahead, and the daily pricing, then, is compared against the market for the month, because the desire is to try to stay close to that. So in that sense, you have Avista Energy's actual daily prices against the Tier 2 market and there is a sharing that occurs.

Q. I understand that that is the company's proposal. Isn't it true that daily price swings relative to the first of the month price -- I should say first of the month index price -- are typical of the natural gas market?

A. The daily pricing tends to be different than the first of month, yes.

Q. And similarly, are daily price changes between different basins also typical --

A. Yes.

Q. -- of the natural gas market? And buying gas from the lowest-cost basin is what you would expect of either Mr. Gruber or Mr. D'Arienzo?

A. That's correct, and that's what occurs under the mechanism, yes.

Q. Or to be generic, I suppose any prudent Avista Utility gas manager?

A. Yes.

Q. I'd ask you to turn to page three of the same Exhibit Number 6. Looking at Number 12, the Commission's policy directive says that narrowly-focused incentive mechanisms can create an opportunity for gaming; correct?

A. Yes.

Q. And your response here suggests that the company's proposed mechanism is, in quote, designed to prevent gaming or manipulation of results; is that accurate?

A. Yes.

Q. Would you agree that the overall mechanism is made up of a number of segments?

A. Yes.

Q. And would you agree that each of these smaller segments could be gamed?

A. I don't think so, and that's -- the reason for that is we do have the 80/20 around each of the components so that they don't have an incentive to use, for example, daily purchases instead of storage, because the sharing is 80/20 on both.

And in the same way, when you optimize

transportation, you don't have an incentive to do transportation versus basin optimization, because both of them are shared 80/20, and so Avista Energy then has an equal incentive across all the elements to make the best deal possible.

Q. I understand that's your position, but my question was with regard to specific elements of the benchmark mechanism. And so it's my understanding that your testimony is that the proposed mechanism is structured in a manner that would prevent Avista Energy from gaming any of the smaller components of the proposed mechanism; is that correct?

A. Yes.

Q. Well, let's discuss a hypothetical. Let us assume that the Commission approves the company's proposed mechanism and, during the coming winter, Avista Energy under-forecasts load for that time period. Do you understand what I'm saying?

A. Yes, I think Avista Utilities is the one that actually puts together the forecast.

Q. All right. Avista Utilities and/or the Strategic Oversight Group. Let's hypothesize that that load is under-forecast. If such were done, it would virtually guarantee that daily purchases or storage withdrawal would be necessary, would it not?

A. If loads are higher, then you'll have to buy from the market daily or pull storage.

Q. So your answer's yes?

A. Yes.

Q. And again in this hypothetical, if the daily prices are higher than the first of the month index price, Avista Energy would withdraw gas from storage and thus earn 20 percent of that benefit; correct?

A. I guess it would depend on the pricing as to how that would work.

Q. Yes, and the element of the hypothetical that I gave you in the question assumes first that daily prices are higher than the first of the month index price. Do you understand that?

A. Okay. I'm with you so far.

Q. Okay. So under that circumstance, where AE -- or excuse me, AU has under-forecast load and where the daily prices are higher than the first of the month index price, under the proposed mechanism, Avista Energy would withdraw gas from storage and in so doing would earn 20 percent of the benefit derived; correct?

A. If daily prices are higher than the first of the month, there would be a cost associated. I'm not sure that all the elements match up here. I'm sorry.

I'm not following. You're talking about daily prices being higher. But they're pulling storage, so they're not making any daily purchases.

Q. They're withdrawing from storage; correct?

A. Instead -- okay. They're pulling from storage, which is a lower cost than daily.

Q. My hypothetical to you is that if the daily prices are higher than the first of the month index price --

A. Okay.

Q. -- under the proposed mechanism in that situation, Avista Energy would withdraw gas from storage. That's how the mechanism is proposed.

A. Not necessarily. The decision to pull from storage on a daily basis is really going to be based on the current daily price for gas versus the forward price for gas. If the daily price today is five bucks and the forward price for next month is four dollars, then you would pull from storage and you would buy the gas to the future. So it's really not a decision of daily price versus first of the month as to whether you would pull storage or not. There's more to it than that.

I guess I have trouble with the hypothetical, because I'm not sure -- it sounds like you're assuming that there was an intentional understatement of what the loads are, and my understanding is, and you can verify this with Mr. Gruber, is that the Utility puts together that forecast, and obviously there's a lot of scrutiny around what those forecasts are.

Q. I understand that. And let's -- just so that we're clear, let's go back to the hypothetical. Avista Utilities under-forecasts load, the daily prices are higher than first of the month index prices, and just to address your concern, let's also assume that in that circumstance in this hypothetical Avista Energy chooses to withdraw gas from storage. Do you have that in mind?

A. Okay. I think I'm with you so far.

Q. All right. In withdrawing gas from storage in that circumstance, the proposed mechanism would create an 80/20 sharing for that withdrawal, with 20 percent of the benefit accruing to Avista Energy; correct?

A. There would be an 80/20 sharing if they pull from storage.

Q. Thank you. And there's nothing specified in the company's proposed mechanism that would prevent this type of gaming through under-forecast of load, is there?

A. No, I think there is. You have the Strategic Oversight Group that includes Mr. Gruber, who's the manager of gas supply for the Utility, you have our manager of risk management who is involved in that, and then you have Mr. D'Arienzo, from Avista Energy. So there's a lot of oversight as to what those forecasts are, so I would not agree that that's an outcome that would occur.

Q. Well, if that's the case, then, let's turn to the source, which would be the company's tariffs. Sorry. I got my exhibit list out of order here. Here's Mr. Hirschkorn. It would be Exhibits 152 and 153. Can you point me to where in the tariff it is that the tariff has a specification that would prevent under-forecasting of load?

A. I don't know that it's specifically listed in here, but we would be glad to add something in here that would address the oversight that occurs under the Strategic Oversight Group.

Q. So your answer, then, is that, to your knowledge, there's nothing in this tariff that would prevent the type of gaming which I described in my hypothetical; is that correct?

A. Not in the tariff, but in the proposal there certainly is.

MR. CROMWELL: I have nothing further for Mr. Norwood. Thank you, sir.

CHAIRWOMAN SHOWALTER: Might as well take lunch. Well, let's see. I guess are you going to follow up on anything else that is produced over the the lunch hour or are you done?

MR. TROTTER: Are we off the record?

JUDGE MACE: Let's be off the record.

(Discussion off the record.)

JUDGE MACE: Very well, then. Let's be back on the record. We'll adjourn now for lunch until 1:30. Thank you.

(Lunch recess taken.)

JUDGE MACE: Let's be back on the record. I wanted to acknowledge that we received here up on the bench a copy of what's been marked Bench Request Number 1, and I believe it's been distributed to the parties. Mr. Meyer, would you just briefly explain what this is?

MR. MEYER: Yes, I'd be happy to. In response to what we understand to be Bench Request Number 1, we furnished an excerpt from our response to Data Request Number 3 that had been issued by the Staff early on in this proceeding. The nature of the request was to produce every document analyzing the benefits to Avista Energy of managing the gas procurement and capacity management functions for the Utility, Avista Corp, and this is a summary sheet out of that document, and it purports to show a calculation of the benefit -- excuse me, calculation of the results of the mechanism in place at the time throughout the entire period since its inception, since September of 1999, right up through February of 2003.

And Mr. Norwood and Mr. Gruber, for the Utility, and Mr. D'Arienzo can speak more to any specific questions you might have on that.

JUDGE MACE: Thank you. Is there -- well, I'll admit this response to Bench Request Number 1 at this point.

And let me ask Mr. Trotter, does Staff have any cross-examination with regard to this exhibit?

MR. TROTTER: I have a few questions, yes.

JUDGE MACE: Go ahead.

MR. TROTTER: Has this been assigned a number?

JUDGE MACE: Bench Request Number 1. I hadn't assigned it an exhibit number.

MR. TROTTER: Okay. Should I just refer --

JUDGE MACE: You can refer to it as Bench Request Number 1.

C R O S S - E X A M I N A T I O N

BY MR. TROTTER:

Q. Okay. Let's refer to Bench Request Number 1, Mr. Norwood.

A. Yes.

Q. First of all, do you recall before the break you and I were discussing what the actual basin optimization benefits were to Avista Energy from the inception of the mechanism through February of 2003? We were looking at Exhibit 55-C for that purpose, do you recall that?

A. Yes.

Q. And the total figures that we discussed on that exhibit are the very ones shown on the first two lines of this exhibit. Would you accept that?

A. Yes.

Q. So the total basin optimization benefits actually received by Avista Energy through February of this year was around 2.87 million; correct? Excuse me, 3.87?

A. It's 3.87, right, through that time period.

Q. Okay. Now --

CHAIRWOMAN SHOWALTER: Mr. Trotter, can you just -- I'm just looking for the right cell.

MR. TROTTER: Right. The first two lines of data, Forward basin optimization and basin optimization P&L.

JUDGE MACE: Under the total column; is that right?

MR. TROTTER: Well, yeah, but if you look through each of the columns, and then there's a total, which is the second from the right, there's a total column, and that is the total basin optimization benefits actually received by AE for the total time period, and you have to add those up to get it.

CHAIRWOMAN SHOWALTER: Oh, I see. That's what I was failing to do. Thank you.

MR. TROTTER: That's approximately $3.87 million.

CHAIRWOMAN SHOWALTER: Thank you.

Q. I believe you said in your testimony that, and I don't have it in front of me, but there was some offsetting factors. Was that relating to the third line, the peaking P&L?

A. Yes, under the arrangements that were in place during this time period, Avista Energy was actually covering the costs on what's referred to there as the line three, peaking P&L, and under the same total column, you can see there's a negative $8.8 million. And so when you net those out, they receive the benefits from the basin optimization, but they absorb the costs from the peaking, and so when you net it out, then there was a loss that has actually occurred to date with their management of the benchmark mechanism for them. And most of that was driven from the 2000 time frame.

Q. Okay. That was during what's commonly known as the California energy crisis that rippled into this state; correct?

A. It was the time of very high prices in the West; that's right.

Q. Okay. And apparently Avista Energy had not made contracts for -- firm contracts, fixed price contracts in advance for peaking services to meet peaking needs during that time frame; is that fair to say? It had to go to the market to pay very high prices for peaking?

A. Well, this is really related to the intra-month variability, and so it's hard to buy contracts in advance to cover. You don't know what your daily loads are going to be, you don't know what the weather is going to be, and so this is the daily variability that occurred with those high prices that were there, and they were absorbed in that portion.

Q. And in the past, Avista Utilities has had contracts in place for peaking services, has it not, before the benchmark mechanism?

A. You'd need to talk to Mr. Gruber. I don't think that there were contracts in place that would cover this type of variation.

Q. And what changes were made in the mechanism to address that risk?

A. Under the three lines under the total column, the basin optimization and the P&L of $8.8 million, the negative value, the proposed mechanism would share all three lines, 80/20, 80 percent to the Utility and 20 percent to Avista Energy. So if the proposed mechanism had been in place during this period, Avista Utilities actually would have been worse off.

Q. How did the change in April of 2002 to the tiers change the risk as to this particular item?

A. I think I'll have to have you ask Mr. Gruber on that. I really don't think it changes, because the tiers really fixed the price on the first 50 percent, and then a portion of the second, but you

still have some variability, some exposure to the daily swings that would need to be covered.
Q. Did the $8 million loss in 2000 give rise to discussions between AE and AU regarding the propriety of the benchmark mechanism?
A. Mr. Gruber or Mr. D'Arienzo would have to speak to that.
Q. You're not aware of any yourself?
A. I believe there were discussions. I'm not sure what the nature was of discussion.
Q. Take a look at the left-hand column for September-December of '99.
A. Yes.
Q. I'm finding that the numbers don't add, and I just want you to tell me where I'm off, if I am. If you look at the first bold line, total system P&L?
A. Yes.
Q. 2.359 --
A. Right.
Q. -- million. And then I tried to get that number through the following lines, either by adding the Avista Utilities actual total P&L, which is the next bold line of 1.25 million, and AE's actual total P&L of .5 million, and that didn't add. Then I added the Avista Utilities share and the Avista Energy

share, 1.155 and 1,602,000, and that didn't add
either.
     A.   Right.
     Q.   So just explain how these numbers add -- how
do I replicate the 2.359 million in the total system
P&L column as between the two firms?
     A.   There is a formula, and unfortunately I
don't have it, but Mr. Gruber or Mr. D'Arienzo could
walk you through the different lines that you would
tally up to tally those figures.
     Q.   Is it fair to say, Mr. Norwood, that Avista
Energy takes more risk under the mechanism than
Avista Utilities would take had it operated its own
gas procurement function during this time frame?
     A.   I don't think that's the case. Avista
Energy, actually during this time frame, took on the
risk that the Utility would have borne, and that's
what this shows. The bottom line here is that Avista
Energy, by actually losing money on a net basis, the
1.1 million in the bottom right-hand corner, those
are costs that the Utility otherwise would have borne
during that time period.
     Q.   But you're saying that Avista Utilities
would have entered into the same transactions that
Avista Energy did during this time frame?

A. Not necessarily the same transactions, but they would have been exposed to the same risks that were out there.

Q. But doesn't that just depend on how they responded to those risks?

A. It would depend on how you respond to that.

Q. And we don't know how Avista Utilities would have responded because -- during the benchmark mechanism, because Avista Energy was doing that function at the time; correct?

A. Correct.

MR. TROTTER: That's all I have. Thank you.

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: Nothing further on this exhibit, Your Honor.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Mr. Norwood, I want to ask you probably some follow-up questions on the questioning this morning, and then some questions of my own that I have from reading your testimony, but I will just say, in the background, I've got four subjects in my mind, so that you can keep that in mind. The issue of prudence, hedging, auditability, and the affiliated interest issue. But more specifically, I'm asking about the mechanism --

A. Okay.

Q. -- as others have. First, just working backwards, with Bench Request Number 1, so that the exhibit is complete, what does P&L stand for?

A. Profit and loss.

Q. Okay. And continuing to work backwards, you had a discussion with Mr. Cromwell about the hypothetical in which there was a certain probability overall of beating the benchmark or not. And the first point I want to clarify is doesn't that all depend on where one sets a benchmark and isn't that one of the challenges in any benchmark mechanism?

A. It certainly is. Depending on where you set the benchmark, it changes the probabilities. Also, you have to make assumptions about what the future is as compared to what the past is, and so that's why it's difficult to make a determination about whether it's perfect or not going into the future, is because you don't know what the future holds.

And part of what we've done here is really put a sharing in on all of the components so that, number one, they're easier to identify what's there, and I think it makes it such that there's more of a symmetrical sharing, I believe. It's closer to follow with all the pieces that are put into place now.

Q. And if there is a certain probability of beating the benchmark, as Mr. Cromwell posited, to the extent that there's a flat, absolute payment in one direction, doesn't that either offset or add to the odds of profiting off of the benchmark mechanism?

Specifically, let's take Mr. Cromwell's hypothetical in supposing -- I think there was a 90 percent chance of beating the benchmark. Now, if -- if there is a payment going in one direction, let's say from Avista Utilities to the ratepayers -- or excuse me, from Avista Energy to Avista Utilities, to that extent, that offsets to some degree that -- or to a degree that probability of beating the benchmark, doesn't it?

A. I'm sorry, I'm not sure if I followed that. Let me -- let me see if I understood. Let me give you an example. First of all, I don't see any -- the only one that I see where there's a high probability of it going one way or the other is the Tier 3, where there's a high probability that Avista Energy's going to lose money on that one, but that's just part of the package deal.

The other piece we talked about was the storage component, and I think the assumption is there may be a higher probability of there being a value to Avista Energy on that one in the long-term, although you can't assume that to be true.

So there are a couple of items where you don't know for sure which way they're going to go, but some of them have a greater probability than others. Then you have to step back and look at the magnitude. What is the magnitude of the exposure or the benefit to Avista Energy and Utility, and we've tried to balance those out.

Q. Well, I believe in your mechanism there are two absolute payments going two ways. Avista Utilities is going to pay Avista Energy about $900,000.

A. That's correct.

Q. So that's a flat amount. And on the other hand, Avista Energy guarantees Avista Utilities -- I've now forgotten whether it's three or five?

A. It's three million.

Q. Three million?

A. Right.

Q. And I think my only question was, when assessing risks and rewards, doesn't one have to take into account those absolute payments, as well as predicted probabilities of beating a benchmark?

A. Yes, I think you do. And if you look at -- you really have to look at each one of those individually and then as a whole, I believe. And the 900,000 that you referred to, the payment from the Utility to Energy, is a payment. And the intent of that is to cover a portion of the cost that Avista Energy's picking up, like the labor cost that we avoid, as a utility, by not having to staff as many people. That's a clear cost you can calculate.

Then you have credit, because they are buying the natural gas for us. When a counter-party wants collateral to be posted because we've purchased $30 million of natural gas from them, they post it, it's their cost, it's no longer the Utility's cost. So some of those are specific dollars, and on the table that Mr. Parvinen had in his exhibit and the table that Mr. Gruber had identifying those different costs, the 900,000 is actually less than what those costs are.

So in that sense, even though there's a direct payment, it doesn't cover all the costs that all the parties here evidently agree that are actually there. Then you'd have to take a look at the three million, which is related to the transportation, and there's been a lot of discussion today about the past and what capacity release has been in the past and off-system sales in the past, but what we have to look at, both as a Utility, in fairness to Energy, as well as Avista Energy looks at is what is the opportunity to the future to capture that value, and it's going to go up and down over time.

So what we're trying to do is put together -- number one, have them guarantee some amount, because some amount is relatively easy to get. So send all of that to the customer. Beyond that, we want to provide an incentive to Energy to get as much money as they can, because we get $4 for every dollar they get.

So an example of transportation, they guarantee three million. If they get six million for the year, then they get 20 percent of the three, which is 600,000. In the end, they get 10 percent of that and the Utility gets 90 percent, and we think that's a pretty good tradeoff to have them going into the market and optimizing that transportation in a way that we really don't have the ability to do.

Q. Okay. So the 900,000 goes perhaps most of the way, but not all of the way toward covering cost, and the three million goes an absolute amount toward a reward to the Utilities, but potentially more, but also, I suppose, potentially -- potentially Avista Energy could end up suffering if it turns out that they only make two and a half million; is that --

A. They would suffer if they made less than three million. And I think some of the concerns that have been expressed here is that there's a reasonably high probability they will reach three million. When you start going beyond that, that's when you start having concerns about not being able to meet that.

Q. All right. Now, speaking of the 80/20, why shouldn't it be a 50/50? And I recognize you could have symmetry, since we're talking about it, at 100 percent or 80/20 or 50/50. Psychologically, it seems to me that 50/50 has a better feel to it, because there's not one side, either, you know, losing more than they should -- not should, but feeling resentful about losing 80 percent when someone else made the decision. And on the other hand, on the upside, I guess everybody benefits, but why not 50/50?

A. And that's where the Utility has to look at what makes sense and what's fair, and Avista Energy's only willing to take so much risk for the opportunity that they have. And as an example, with the transportation, the existing mechanism that's in place today, the first five million goes to the Utility. There's no guarantee, but the first five million goes to the Utility, and then there's a 50/50 after that.

Part of the problem with that is it barely made five million, and so there really wasn't that much in it for them, and from our perspective, we want them to have a meaningful incentive to go after every dollar that they can.

The other part of that is when you get into the commodity side with the Tier 3, the daily volatility, when you're talking about 50 percent of that, that presents some -- it can be a lot of exposure, depending what the prices are, and so then you have to balance a 50 percent sharing on that with a 50 percent on all the other pieces.

On the commodity side, the cost to cover that daily volatility is really a one-way deal on average. It actually costs you more to cover that volatility than the money you can make by selling off the excess if your loads are below that.

So if they're eating -- if you had a 50/50, Avista Energy would be exposed to 50 percent of that, but even though they would have 50 percent of the transportation, you would have to set the guarantee and the benchmark low enough so that you could make those equal and fair.

Q. All right. So basically what you're saying is that there's an interrelationship between where you set the guarantee, that is, the three million or higher or lower?

A. Right.

Q. And the ratio you want to impose, the 80/20 or 50/50, and the risk on the daily piece?

A. That's right. And you can do the math, and that's what's shown in the Exhibit 55-C, where we went back and took a look at what would the numbers be if the proposed mechanism had been in place since September of 1999. And you include all the components, and you include the 80/20 on all the different pieces, and what it shows is, in the last column, the annual average, at the bottom, $987,000 per year for Avista Energy. And then, on the lower left-hand side of the page, you can see two-million-five-fifty-one, which is a tabulation of the benefits that would accrue to the Utility.

So when you start playing with a 50/50 or a 70/30 or putting the guarantee at a different level, it changes the result, and that's the balancing act that you get into. And as we just talked about on the response to Bench Request Number 1, the way it was set up, Avista Energy -- you can talk to Mike D'Arienzo about this, but it is actually taking on more risk and more cost than what he thought, I think, when the original mechanism was put together, and they lost a lot of money in year 2000.

Q. So just -- by the way, you were reading numbers off a confidential exhibit.

A. I'm sorry. You're right, I was.

Q. If that's the case, then we should probably --

A. That's public information in testimony.

MR. MEYER: We're fine.

THE WITNESS: Those pieces were.

Q. All right. Now I'm just going to do a little follow-up to Mr. Trotter's questions. Have there been any changes at all in the mechanism, as it has been operating since it was put in place in '99?

A. Yes. We have put into place the tiers, which fixes the price on a portion of the portfolio. We have modified the storage so that there's one full turn. I think before it was 85 to 90 percent of one cycle, now it's 100 percent. We have an 80/20 on all of the components now, the commodity storage and transportation and the basin optimization. That's a change on all the different pieces.

Q. All right. For what is in operation today, how long has that formula been operated?

A. I believe that is April 1 of '02. I'll have to check that.

Q. All right. If it's not April 1 of '02, get back to us through maybe even another witness or --

A. Okay.

Q. Well, Mr. Trotter asked you a question, you had an answer that had to do with contracts and hedges and there being no sharing. And I have a little note to ask you to distinguish contracts from hedges.

A. Okay.

Q. At least in the context of what your answer was.

A. Okay. Right. We were talking about, I believe, Tier 1, primarily, where what we do is hedge the price. We fix the price on a portion of the commodity that we need for loads in the coming year. So we enter into -- actually, Avista Energy enters into transactions on behalf of the Utility after discussions with the Strategic Oversight Group, so that fixes the price for that portion of the transactions.

And I think what we were talking about was the question of is there a sharing around that, and we have purposefully not proposed a sharing around those hedges, because the whole purpose in entering into them to begin with is to fix the price so that that part doesn't change for customers. If you start doing some kind of sharing, then it starts to unwind the price that you fix. It's no longer fixed, because you're going to charge the customer something different than what you locked in.

Q. Okay. I guess it sounded to me as if people were talking about contracts on the one hand and hedges on the other, but a hedge is a contract; it just guarantees a certain result, doesn't it, for a certain price?

A. Well, you can have a contract to buy index gas at first of month index, but then you can enter into a separate type of contract to fix the price, which would be a financial contract. So both are contracts, but when you talk about hedging, you're talking about locking the price in so it doesn't -- it doesn't change.

Q. Okay. There are a few places in the

evidence where it's talking about Tier 3 being a plus or minus eight percent, and sometimes, when you see something like that, it looks as if there's a swing of 16 percent. But as I read it, it's that it could -- that Tier 3 would probably be eight percent or less --

A. Yes.

Q. -- of --

A. Volume.

Q. -- volume?

A. Of the therm sales.

Q. Right.

A. And depending what the prices are, if you get into a situation where volumes are high and prices are very high, then that's where the impact could come.

Q. All right. So on average, it's going to net to something less than eight percent?

A. On average.

Q. But the price, I suppose, could be greater than that, depending on if the upside was very high; is that correct?

A. That's right. And that's the area where we have the 80/20 to have Avista Energy either pull storage to cover that when prices are high and loads are high or to buy on the market.

Q. And you were asked some questions about Exhibit 19, and I have a note to say see Exhibit 102, page nine, which is not yours, but I think you'll recognize it. Do you have that? It's --

A. Let's see. 102 is Mr. D'Arienzo's rebuttal testimony. Okay. I have it.

Q. Page nine.

A. Yes, I'm there.

Q. Well, I'm looking at lines six through 13 and it struck me that, A, no one's going to know whether situation one, two, three, or four is going to obtain at any particular time; is that correct?

A. That's correct.

Q. Although where you set your fixed and long-term purchases, where you set your expected 100 percent could affect how often you get into one, two, three, four?

A. That will drive whether you're into one, two, three or four, because what we do is Tiers 1 and 2, in those tiers, we actually purchase to the average load, and scenarios one, two, three or four, it's -- the actual loads are either going to be higher or lower than that estimated load.

Q. And then, in looking at these scenarios where it says, for example, in number three, Additional gas must be purchased at the market, should there, in effect, be "or drawn from storage" there?

A. Yes, that's correct.

Q. Okay. And is this where judgment and expertise and I guess scale come in? In other words, what is the advantage of Avista Energy doing this compared to Avista Utility? It strikes me this is getting into the where discretion is exercised --

A. Yes.

Q. -- in addition to some other things earlier, but --

A. Right.

Q. -- this is the heart of it.

A. Right. In addition to the numbers that we look at and the benefits to the Utility, you look at things like -- one illustration or example we've talked about is comparing the mom and pop to a Wal-Mart. And Avista Energy is, in essence, like a Wal-Mart, where they have access to a lot of suppliers, they move a lot of volume, and so they know what the market is. The suppliers are willing to do business with them very quickly because they do a lot of business with them, and so they have the pulse of the market. And so they're able to execute these transactions a lot easier than what we are.

What they also do is they are taking on the, number one, deliverability. It's up to them to make sure that the supplier delivers. If they don't deliver, it's Avista Energy's problem, not the Utility's problem. If the counter-party does not pay their bill, then it's Avista Energy's problem, not our problem. If they ask the company to post collateral, it's Avista Energy's problem, not ours. So there's a lot of those things that they're handling and dealing with that the Utility no longer is through this mechanism.

Q. And that gets to an area I did want to ask you about, which is credit risk. And I understand what you just said, which is if you offload these responsibilities to Avista Energy, then you're not taking that risk; Avista Energy is. So then the question is is each side properly compensated or rewarded.

But my next question is Avista Energy's part of Avista -- Avista Corporation?

A. Yes.

Q. Is the big parent?

A. It's a subsidiary, right.

Q. And what benefit is there to Avista Utility of relieving itself of some of this risk and placing it with Avista Energy when you're both part of the same operation?

A. Avista Energy is actually a separate corporation. They have their own line of credit, they do their own financing, and so they have their own income and expenses. And so this -- the collateral that has to be posted to cover these contracts comes out of Avista Energy and their line of credit; does not come out of Avista Utilities. And so in that sense, the expenses that show up, then, show up on Avista Energy's books, not ours.

Q. And if Wall Street, for example, is giving Avista Utilities ratings on various aspects of its operation, does it help Avista Utility to relieve itself of that credit? Does this make any difference to Wall Street, this kind of contract?

A. This benchmark, I don't think that this is a major driver in what Wall Street's going to look at.

Q. Okay. There was discussion about who makes the decision on forecasting load, and I was a little unclear how it actually ends up. Who has the actual responsibility to let Avista Energy know what the load is going to be? Is that you tell them or you consult with them and they decide?

A. There is a couple of elements to that, and some of it was discussed earlier, when Mr. Cromwell asked a question about is there an opportunity to game the loads and so on, and I didn't realize that in our tariff, it does spell out that when we buy that first 50 percent and the second 50 percent up to the average load, that average load is based on, basically, the historical five-year average calculation. And so it's basically predetermined by Avista Utilities. And so in that sense, that sets the level at where we buy the Tier 1 and Tier 2 natural gas.

Otherwise, on a day-to-day basis, week-to-week basis, it's my understanding, and Mr. Gruber will have to confirm this, that Avista Utilities provides that load to Avista Energy.

Q. I'm not sure I understood the otherwise, because what I thought you were saying was that, in essence, Avista Energy takes the forecasted load as presented to it?

A. Yes, when we're buying that first of month and the Tier 1, that's the five-year calculation of what is our average loads, and then they will go out and buy Tier 1, Tier 2 to match that. But then, when you get within the month, you know it's going to be different.

Q. Oh, yes.

A. And that's where the Utility will provide them, Avista Energy, with the next day or next week loads.

Q. Okay. Yes, I see. And then, in terms of who's making the decision what to buy and how much to buy for Tier 1, again, I was a little confused. Clearly, there's consultation, but whose job is it to buy 12 months out or wait three months, that kind of discretionary decision for meeting Tier 1?

A. Okay. Let me use a chart here to help --

Q. Okay.

A. -- answer that.

Q. And I think this is Exhibit 4, it looks like. Maybe I can just start and walk you through quickly the process from an overview standpoint of the Tier 1 purchases.

First of all, the lower section of that is the -- I guess it's purple here, I'm not sure if it's purple in the exhibit -- is the storage, and that's going to be purchased throughout the summertime, and there is some judgment used as to the timing of when you inject into storage, and that's done with Avista

Energy and Avista Utilities.

Q. But that, for example, it's Avista Energy's call; is that correct? I mean, who decides?

A. That's a Mr. Gruber question.

Q. Okay.

A. But Mr. Gruber weighs in heavily as to what makes sense to them and there's a joint discussion that takes place.

Q. All right.

A. That's a good question for Mr. Gruber. On the other piece, the Tier 1 purchases, as was discussed this morning, we picked a basin weighting percentages in that December-January time frame, and then, from the February through November period, Avista Energy and Avista Utilities is watching the market for the upcoming winter and following period, and they talk about the timing of when they lock the prices in. And again, that's a joint discussion, and Bob can tell you a lot more than I can.

But there's judgment, Avista Energy obviously has their pulse on the market, and so they have a lot to say about when we lock those in, but it is a joint decision.

And as far as the magnitude of what's locked in, what we've done is taken a look at what is the --

basically, the minimum load that you would expect during any of these months if you had an abnormally warm period, for example, and that was the basis for deciding how much do you lock in, and it ends up being roughly 50 percent over the course of the year when you include storage.

Q. All right. In any event, you lock in -- well, you, I don't know who the you is, but in the end, it's Avista Energy who is actually doing the buying?

A. They execute the transactions; that's correct.

Q. And with respect to Tier 1, anyway, regarding prudency, is this Commission entitled to look at that decision and hold Avista Utilities accountable for it?

A. Yes. What we're doing here, really, at Avista Energy, is really not much different than what we would do if it were within a utility, although there's some differences that I want to point out. But the Utility has decided that we want to provide some price stability for our customers, and so we've said we want to lock in the price in advance on a portion, and what we've decided is about 50 percent. So we have asked Avista Energy to execute those for us in taking advantage of their view of the market and so on.

But it's still, in my view, the Utility's choice, in discussions with Energy, to provide that price stability. So in that sense, it's the Utility's choice to do that. When they lock those prices in, there will be specific contracts that will be executed, there will be information regarding what the market price was at the time the deal was done, so it will be well-documented. We want to know, as a Utility, that it was done at the market at the time they did the deal and that it was a prudent deal. And we, as a Utility, are willing to defend that and to present it.

Now, what they do, then, is when they execute those, they are, as I mentioned before, at risk for delivery from the counter-party. If someone doesn't pay, it's their problem, not our problem, and if there's collateral that has to be posted, they post it, not us, so that's a major difference between them doing it and us doing it is they're bearing all those costs for us through this.

Q. Okay. I have some probably pretty minor questions on your testimony, maybe not minor, but this one is page -- this is Exhibit 1, page eight.

A. Okay.

Q. Lines 10 and 11, you say, Under the current Utility risk policy, the Utility is focused only on transactions to balance load and optimize resources. If the -- if the Utility were to engage in these riskier transactions, the Utility's current credit cost would increase substantially.

Now, what does these riskier transactions refer to? Maybe it's the previous paragraph. I'm not sure.

A. That is a lot of the volumes that would be done to buy from one region, sell to another region that Avista Energy enters into that we do not, as a Utility.

Q. See, I just can't -- it's just the sentences that I don't follow. Ten, it says the Utility is focused only on transactions to balance --

A. Yeah, and I think I probably should have worded that a little differently. If the Utility were to do this, it would -- because we, as a Utility, obviously we don't do that, other than Mr. Gruber manages the California gas supply for that state, but right now, the Utility does not buy and sell gas to balance load, so that could have been worded differently.

Q. So what you mean to be saying is if we deny your proposal and you then have to take on transactions to balance load and optimize resources, that that is more risk than otherwise?

A. Well, we'd have a choice to make. If it moved back in the Utility, we'd have a choice to make of do you just buy what you need to cover load and sell your surplus, or do you try to capture some of the benefits that Avista Energy's doing by moving a lot of volume to optimize that pipeline transportation.

And I'm not sure that we would want to move, in the Utility, I'm not sure that we would want to enter into the types of transactions that Avista Energy does. That's not our primary focus.

Q. All right. Page five, line 19. Excuse me, I mean page five of Exhibit 1.

A. Yes.

Q. And you have examples there from Idaho and Exhibit -- oh, 3, I'm sorry. Yeah, Exhibit 3, page five.

A. I'm there.

Q. You are discussing Idaho and Oregon. And in Idaho, first, what is the sharing mechanism for Tier 3, if it has that feature?

A. In Idaho -- let me look for just a moment. In Idaho, it's consistent with what we have in place today, so you have the -- let me think here. Right. We still have the hedges in place for Tier 1, then you have the Tier 2, but Avista Energy, rather than having a Tier 3, where it's shared 80/20, Avista Energy's actually at risk for most of the variability around the daily loads versus the first of the month loads.
Q. So is it something like the reverse, like 20/80, or --
A. It's probably more like a 90/10, where Avista Energy absorbs the 90 percent and Utility more like 10. Mike D'Arienzo could give you a better feel for the risk they're taking there.
Q. So in Idaho, is there any absolute guaranteed amount comparable to the three million in your proposal?
A. There is a guarantee in Idaho. It's a $1 million guarantee, with an 80/20 after that on the transportation.
Q. Okay.
A. That's -- Idaho is roughly a third of the Washington-Idaho gas business.
Q. So on the basin sharing mechanism, it's --

Idaho's is comparable to what you are proposing?

A. No.

Q. No?

A. That's the point that I should have added just a moment ago. When I talked about Avista Energy is taking the risk around that daily volatility, they're also keeping basin optimization, and that's the tradeoff. They're taking the risk here and they're getting the benefit of the basin optimization.

Q. Which was here, when you said here?

A. I'm sorry.

Q. They're taking the risk -- they is Avista Energy, is taking the risk in Idaho?

A. Yes.

Q. Where?

A. Around the -- it's actually called Tier 2, where you buy natural gas up to your estimated average, and to the extent your loads are higher or lower than that, Avista Energy bears the risk on that daily volatility. And they're bearing all the risk of that. Well, most of it. There is some portion, if it gets extreme, then there's another factor that kicks in. But they're bearing the bulk of the risk around that daily load variability, and they're

keeping the basin optimization opportunity.
Well, in this proposal, what we're proposing is there's an 80/20 sharing on the daily load variability and an 80/20 sharing on the basin optimization. That's where, when we talked through this over the past year, you know, Staff had indicated we want the basin optimization. So we said, Okay, you can have that, but Avista Energy's not willing to bear the risk on the daily load variability. It's got to balance out there.
Q. Okay. So you are not seeking in particular absolute consistency from Idaho to Washington to Oregon?
A. No.
Q. Again, in Exhibit 3, could you turn to page 16?
MR. MEYER: Exhibit 3?
CHAIRWOMAN SHOWALTER: Yes.
Q. And I'm looking at lines 13 through 16. And you're saying there would be less of an audit trail with a third party than for -- than if this is provided by Avista Energy. And I'm a little unclear of what our authority over Avista Energy is. I have a fair sense of what our authority over Avista Utilities is and perhaps what we could get at through

Avista Utilities, especially in order to approve an arrangement, but is there anything to stop Avista Energy from engaging in a lot of business of some sort, which I'll call side deals, and by that, I just mean a business that is not visible to us in terms of its overall buying and selling of energy on a given day?

A. That would involve the Avista Utilities assets?

Q. No, that doesn't.

A. Okay.

Q. In other words, what I'm trying to get at is if Avista Energy is doing this job for Avista Utilities, we have some benchmarks, and I guess that benchmark is -- the critical index is how we gauge Tier 3 buying and selling, or at least it's one of the ones that's critical?

A. I think they're all critical. Tier 1, there's a benchmark, and that is the market, and that will be documented. Tier 2 is the first of the month index, which is what it is. And then, as you mentioned, for Tier 3, we're measuring the daily results against that first of the month index.

Q. All right. But I gather -- I guess in all instances under the proposal, we would be evaluating

Avista Energy's performance compared to something that it cannot affect. That is, an index or all traders for that day; am I right?

A. No, I don't -- I think it's partially true. Obviously, the market is going to be the market and it's going to change as it wants to change, but what we have to keep in mind for Avista Energy and for this mechanism is that there are choices to be made, especially when you get into the daily markets, about whether you use storage or whether you buy in the market on a daily basis to cover your loads, and that's where the incentive is there to make sure that they make the right choices there, and that's where there are conversations between Mr. Gruber and Mr. D'Arienzo as to whether you pull storage, because at some point you start to jeopardize reliability.

Q. I suppose it's this. Supposing there's a transaction that Avista Energy is going to do that's more profitable to it than the 80/20 split, so it prefers to call that more profitable transaction somebody else's transaction, and maybe a less profitable transaction Avista Utility's transaction, even though the incentive is to beat the market, in any event?

A. I see what you're saying. The way this is set up, and this was discussed a lot in the last year, to try to ensure that there wasn't the opportunity or that you wouldn't get into questioning why didn't Avista Energy assign the good deal to the Utility and the higher cost deal to somebody else --

Q. Right.

A. -- their own book. And the way this is set up, you can't do that. Tier 1 is fixed price assigned to Utility; Tier 2 is a known deal, known contract assigned to Utility; Tier 3 is going to be their average costs, if loads are higher, they have to go to the market to buy it, it's going to be their actual costs from those supply basins, and if they don't buy any from that supply basin, it will be the gas daily -- published gas daily price from there.

And that's where -- if you look at Mr. D'Arienzo's exhibit, they did an analysis to see what their prices were during '02, and it showed they were within a penny, basically, of what the daily prices were. So there's really no way for them to game it and no way for us to not see it, because it's -- that's one of the nice things about this, even though this proposal is a lot more work than the existing mechanism in place. And part of that is to go to the work, go to the effort to basically add transparency to all the components, so that there's no place to hide the transactions.

CHAIRWOMAN SHOWALTER: I think those are all my questions. Thank you.

THE WITNESS: Great, thank you.

JUDGE MACE: Commissioner Hemstad.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. I think various of the questions I might have asked have been inquired into here. First, your discussion about Wall Street. Avista Utilities, I assume, is at risk by the performance of Avista Energy, whether it does poorly or it does well, because you're an integrated company. Your ultimate credit rating will be determined by the performance of the entire corporation, not just Avista Utilities. That's true, isn't it?

A. We do have a corporate -- overall corporate credit rating; that's true.

Q. So to that extent, if Avista Energy -- I'm not suggesting this is the case -- but undertakes high risk transactions and loses, that could have the effect of hurting Avista Utilities' credit rating?

A. And I think, as you probably know, Gary Ely has made an effort to scale back that operation and to focus more on an asset-backed approach to business, and I think we've seen that their operations are -- have been fairly stable in terms of profitability, and so that's what we're working toward as a company, is to have them be a relatively stable operation.

Q. The Staff's primary recommendation is that this function be returned to Avista Utilities. Were we to order that, what would that entail?

A. Well, we would need to add staff in the natural gas area to manage the storage, as well as the commodity and the transportation within the Utility. It would involve increased cost in terms of credit, as I mentioned earlier. As we purchase natural gas, it would be the Utility posting collateral, not Avista Energy. It would take some time to gear up to add that staff and roll that back in, as well as you think about the transportation and the opportunity to optimize that, there would be a decision made about are we going to get into moving large volumes of gas to optimize that. In the past, we have not, and I doubt that we would within the Utility, so we would be giving up some opportunity there.

Q. But that would -- would that replicate the environment in pre-1999?

A. The -- I guess the answer is yes and no. Yes, we would be doing it within the Utility, like we did before. I think the environment is different today than what it was before in that -- in a number of categories. The counter-parties, there are fewer counter-parties to do business with. There are concerns about who you do business with because of the number of bankruptcies and concerns about people paying their bills. If you look at the volatility of pricing, it's different than what it was before.

So if you look at the -- from the Utility's perspective, and I keep asking Bob Gruber this, as the manager of gas supply, is, you know, how much value is there in Avista Energy doing this, and the answer I keep getting is there's a lot of value given the circumstances that we have today versus the way it was in the past. There's actually -- there's a greater need for Avista Energy to be managing this now than what there was in the past.

Q. Well, Avista Energy faces the same issue of limited counter-parties, doesn't it?

A. Yes, they do.

Q. I mean, it doesn't have any more than the

Utility would have?

A. I'm not sure if that's the case -- they actually may have more counter-parties they would do business with than what we would have. There would be some who -- because you don't do a lot of volume, they may not want to do business with us on occasion, whereas Avista Energy does a lot of volume. As I mentioned before, if there's a nonpayment by a counter-party, it's Avista Energy's issue, not ours.

Q. Mr. Trotter asked you some questions about the integrated resource plans. And in Exhibit 22, the graph at page C9, I guess I didn't understand very well the questions and your answers about this. It shows 1993 through 1996, and now -- and these are off-system sales. And now, all of these were occurring with the responsibility for purchases within the Utility. That's true, isn't it?

A. Yes, and I think if you look at the chart here, I think the left-hand bar is revenue, I believe, and then the right-hand bar is margin, and so you can see the margin is relatively small.

Q. Oh, I see, okay. Now, if this graph were projected forward through 2003, what would it show?

A. I'm sure Mr. Gruber or Mr. D'Arienzo could answer that. I don't have the data.

Q. There's nothing -- there's no exhibit that would reflect that?
A. There may be, but I may have to have them point you to that.
Q. Trying to compare apples and apples, the $3 million guarantee, would that reflect the off-system sales margin or the off-system sales revenue?
A. That's margin.
Q. So am I reading this correctly that, at least for these four years, the $3 million guarantee would have been more beneficial to the Utility?
A. Well, you have to keep in mind that the three million is margin from off-system sales, as well as capacity release. And the prior page includes the capacity release and -- I'm assuming that that's margin. But again, you have to go back to what were the circumstances, what was the available capacity then.
Q. Sure.
A. Right.
Q. All right. I'll pursue that with the other witnesses to -- for that to be carried forward, what it would look like.
Mr. Parvinen, in his testimony, asserts that the tariff arrangement, if I recall his testimony

correctly, means that the system will be less nimble than if the company itself were buying and selling. What's your response to that?

A. Less nimble in terms of flexibility --

Q. Yes.

A. -- on buying gas? I don't think that's true at all. You can walk through the different pieces to think about that. Tier 1, you actually make your purchases from the February through November time period for the upcoming winter. That's a huge time frame to think about, to watch the market, to look at conditions, and then to lock in. And so over that February through November time frame, you have flexibility to make choices around when you lock in those prices. For Tier 2, that's the first of month index, and that is what it is.

On Tier 3, there's really maximum flexibility to either pull from storage, to the extent you're not jeopardizing reliability. You don't want to pull so much from storage that you don't have it to cover you later in a cold spell, but you can either buy from the daily market or pull from storage, so I don't see that there's a restriction on the resources available to cover your loads and to fix prices.

Q. Well, and then, finally, I'm trying to grasp the ultimate relationship between this proposed arrangement and the power cost adjustment mechanism. And this had been discussed, but could you walk me through that?

A. The purchase gas adjustment mechanism?

Q. Yes.

A. Okay, all right. What we do here is basically each month we determine what the cost of gas is for our customers under the benchmark mechanism, so that means we would look at -- let's pick a month, of November, for example. We would know what the fixed prices are for that level of volumes, and that's the amount that would be billed to the Utility, because it's fixed ahead of time.

Then you would have the next level at first of the month index, and it is what it is times the volumes. And then you would have whatever your variations in loads are, what the costs are, you'd have those dollar figures. To the extent you had storage transactions, that would be accounted for. Any off-system sales or capacity releases would all figure in there and there'd be a bill from Avista Energy for all of that.

That, together with other transportation costs, would be compared against the rates that are -- costs that are embedded in rates.

To the extent there's a difference, it would be deferred and go into a balance, and then each August, roughly, then we would file to rebate whatever the balance is that's a positive or surcharge, to the extent that costs were under-recovered during the period, together with a forecast of what the market is going to be to try to set rates at a level that's going to reflect the market.

Q. Doesn't the net result of all of that mean that this fairly mechanical process, if that's a fair way to describe this, largely predetermines what the purchase gas adjustment end result will be?

A. Which part are you referring to as mechanical that might predetermine?

Q. Well, this entire scheme is what I'm referring to.

A. I don't think it predetermines what the price will be. The one element that would would be the Tier 1 purchases. To the extent you've locked those in, you know that those are going to be the costs that you're going to incur for that period. For the first of the month index, you're not going to know what those are until you get there, until you get just before each month.

For storage, once you get to the summer, then you'll know what you have in storage, so to some degree, that will determine what your costs are. But otherwise, for Tier 3, for transportation, those other costs are going to be dependent on what the market is at the time as you progress through the months.

Q. But the market is largely the benchmark for -- well, the first of the month and storage, isn't it? What I'm trying to get to is -- and this may be a good thing, not a bad thing -- that the purchase gas adjustment proceeding is going to be pretty simple, isn't it, just to see -- just to assure ourselves that this scheme has been properly handled?

A. It should be more straightforward for a number of reasons. One is we have really laid this thing out in a way that everything is transparent. You know what the fixed price purchases are, you know what storage was, you know what the first of the month index is, what it is, the daily loads, all the information's available to know what that is.

Every transportation deal that's done on our system comes on the invoice in the pipelines. So we know exactly what Avista Energy did. It's all laid out. For storage, every time we touch storage, every time they touch storage, inject, withdraw, it's all identified. So in that sense, it should be a lot more straightforward than it has been in the past.

CHAIRMAN HEMSTAD: That's all I have.

JUDGE MACE: Commissioner Oshie.

E X A M I N A T I O N

BY COMMISSIONER OSHIE:

Q. Mr. Norwood, I believe that you testified earlier that you are not a member of the Strategic Oversight Group. Is that -- am I correct?

A. That's correct.

Q. Who is -- for Avista Utilities, who's on the Strategic Oversight Group? And if you know for Avista Energy who's a member of the group?

A. Yes, Mr. Gruber, who's a manager of gas supply, who's the next witness in line, is on that group. Ms. Pat Gorton, our risk manager within the Utility, is on that group, and then Mr. Mike D'Arienzo, from Avista Energy, is on that group. Those are the formal participants.

It's my understanding that there are folks from rates and accountants from the gas supply area that also participate periodically to follow what's going on.

Q. And when you say from rates and from your -- the accounting staff, I presume that to be from Avista Utilities?

A. Yes.

Q. Now, let's walk -- maybe we can walk through the tiers, and I can get a better understanding of what the Strategic Oversight Group is responsible for. In Tier 1, which is the purchase of 50 percent of your load, or I'll just call it your base load, let's put it that way, the Strategic Oversight Group would meet sometime prior to -- maybe you can help me. When would they be meeting to make a decision for the gas purchases for the upcoming year? In November, if I remember from the testimony?

A. Yeah, and I'll have to be careful here. As you've heard during the day, I've referred a lot of questions to Mr. Gruber, and that's where -- he can speak in detail as to what they do and the timing, but we set the -- as I mentioned, the basin percentages, the weightings in that January time frame, and that sets the foundation for the purchases that are made from each of the supply basins.

Then, in the February through November

period is when the Strategic Oversight Group would work together to start layering in these Tier 1 fixed price hedges and, to be honest with you, that's about as far as I can go. Mr. Gruber can elaborate a lot better on the details of what they discuss and the timing.

Q. On the -- so as far as, then, for the Strategic Oversight Group, let's stick to the Tier 1, does it require -- is it a consensus decision of the individual members of the Strategic Oversight Group in making a decision to buy a particular resource, or does the -- well, perhaps -- let's stop there. One question at a time.

A. I hate to do this to you, but I think it would be better if Mr. Gruber, who's on that group and is probably the one making the decision, would answer that question for you.

Q. Well, I guess is it your understanding that Mr. Gruber, then, directs Mr. D'Arienzo in the purchases? In other words, is the Utility -- maybe just ask it in a general way. Does the Utility tell Avista Energy what to buy for the resources in Tier 1, your understanding?

A. The Utility tells them how much to buy in terms of the overall Tier 1 level. As far as the timing, again, I'll have to defer to Mr. Gruber as to who makes the call as to when you lock in a layer of gas supply.

Q. I thought from -- maybe I misunderstood your testimony, but I thought that Avista Energy, at least for its Tier 1 and Tier 2 -- excuse me. Maybe it was Tier 2 that was based on the historical averages. So for Tier 1, the Utility tells Energy how much gas to buy for the upcoming season?

A. Well, what we discussed awhile ago was the historical average, and that sets the average load by month for the upcoming year, and that's based on the historical figures. So that sets the total for Tier 1 and Tier 2, and then it's my understanding that the Tier 1 really represents basically the minimum load or the base load that you would expect to have -- you're pretty confident you're going to have that much load every month across all the months, is my understanding of what dictates that Tier 1 level of hedging.

Q. So then, if I can then maybe restate it, that the Utility tells Energy how much gas to buy, but that figure's derived from the Utility's historical use of that resource over the last five years?

A. That's my understanding, yes.

Q. Okay. Now, as far as the -- so I think we've covered Tier 1 and Tier 2, generally. I can ask Mr. Gruber or Mr. D'Arienzo about this, as well, but -- now, as far as the Tier 3, either you have to -- the Utility either has to purchase or -- it has to balance the load, so it's either going to purchase or sell. And at that point is when a decision is made to either buy or sell. I imagine it's pretty straightforward. In other words, if the Utility looks like it's going to be light based on the next day's forecasted load, then it will notify Energy that -- of its upcoming deficit and Energy will buy or Energy will provide whatever resource is necessary for the Utility to balance its load?

A. That's right, and that will be a decision to either pull storage to cover or they will buy on the daily market to cover that. That's basically the only two places you have to go.

Q. Now, is the -- the decision, then, to buy is made by the Utility, or to pull gas from storage, or is that a joint decision that's made by Utility and Energy?

A. In my discussions with Mr. Gruber, who is the guy to confirm this, is that he is very concerned about making sure that there's a sufficient amount in storage through the wintertime to make sure that it's there to cover loads, and Mr. D'Arienzo also is concerned about that. So it's my understanding there's discussion that goes on between the two as to whether to pull storage or whether to buy on the daily market.

Q. Well, and who would make that decision, then? Would it be the Utility telling Energy, Well, based on these factors, we think you should pull X amount from the storage and buy X amount from the market? I suppose that kind of result's quite common.

A. My understanding is the Utility makes the final call. Mr. Gruber can give you maybe a little more color around what the discussion is and how that -- how they come to a decision. Again, since I'm not in the meetings, it's difficult for me to elaborate more on what the discussion is and how the decision is made.

Q. As far as, then, the -- what role does the Strategic Oversight Group have in off-system sales?

A. That's a good question. I'm not sure. Mr. Gruber would probably -- and Mr. D'Arienzo would have to answer that.

Q. I'd ask you the same question, then, for the capacity release function that's performed during the season. Do you know what role the Strategic Oversight Group has in that?

A. No, again, I'd have to defer to Mr. Gruber.

Q. Now, as far as the basin weightings, Mr. Norwood, the Strategic Oversight Group meets and makes a decision as to how to weight each basin for the upcoming season?

A. I believe that Avista Energy is involved in that. It's Mr. Gruber that makes the ultimate call and actually sends the notice to the Commission in that December time frame.

Q. Do you know how much capacity Avista Utilities has on contract from the Alberta fields, or AECO?

A. I don't. I think it may be in one of our exhibits, but I'm sure Mr. Gruber would have that.

Q. Could it be 50 percent, or does that sound about right?

A. I think it's in that neighborhood. Exhibit 52, page four, has some volumes on it for AECO, Rockies and Sumas. Again, Mr. Gruber would have to confirm these volumes. AECO, it shows 68,483 decatherms per day, and at the bottom of this chart, you can see it shows maximum transportation allowed at average day is 35 percent Sumas, 32 percent Rockies, 63 percent AECO. Again, Mr. Gruber's a lot more familiar with those components than I am.

Q. Does the Utility retain the right in its contract with Avista Energy to control the capacity release arrangements that are made by Energy on its behalf?

A. I believe there are discussions related to long-term releases versus short-term. And I apologize for deferring so much to Mr. Gruber, but he is the one that is the hands on, that drives it, so I think he would be able to give you a good answer on that.

Q. Now, just as a general question, Mr. Norwood, and I think you touched on it, but why is it important to Avista Utility to embody this purchase, gas purchase strategy in a tariff?

A. Well, our original proposal to put it in a tariff is really driven by the policy statement and the effort that we have tried to make to honor that policy statement and be consistent with it, and so that's the first part. I don't know that it necessarily has to be in a tariff so long as we have a Commission order approving their proposal. I think it does help to have it in the tariff. That way you have the details around how the calculations are made and how the mechanism works, but personally I'm not sure that it's necessary, as long as there's an understanding through the filing here what's going to take place if the Commission approves this type of mechanism.

Q. I'd like to maybe touch briefly again on a question that Mr. Hemstad asked you, and that is, you know, why is the Utility, or maybe Energy, perhaps really they're working in partnership here, less nimble through the use of a tariff than it is through -- without one?

A. I don't think, from an operating standpoint, having a tariff versus not having a tariff makes a difference. The Strategic Oversight Group is still going to meet, they're still going to talk about the best transactions for the company, so I don't think it takes away -- in fact, we had more details in the tariff previously around the synthetic schedule and that sort of thing, but we've pulled that out to provide more flexibility on injections, as well as flexibility on the Tier 1 purchases, so I think there's flexibility built in.

Q. Well, I guess what I understood Mr. Parvinen to mean by that was at least in a couple of areas. For example, if the Utility thought it best to buy 60 percent as an example, hypothetically, of its needs in its Tier 1, you know, fixed price resource, would that require a tariff change?

A. I really -- I don't think it necessarily would. Again, it comes back to I think that the Utility needs to manage the gas procurement in a way that it believes is prudent and in the best interest of its customers, and then, when the PGA time comes, to demonstrate that those costs are the best costs for customers.

So I think there's still flexibility for the company to choose to hedge more, if it feels like that's the right thing to do. Now, in the past what we've done is we've come to the Commission and said we want to hedge more than what we're hedging and gain approval from the Commission.

I think in the mechanism, and Mr. Gruber can confirm this, but I think there's a certain level of hedges that are planned and then there's another level of hedges that are discretionary, which provides that flexibility to do more or less.

Q. And that would be, as you say, a decision of the Strategic Oversight Group?

A. Yes.

COMMISSIONER OSHIE: I don't have any other questions.

JUDGE MACE: Thank you. Mr. Meyer.

MR. MEYER: Thank you.

R E D I R E C T E X A M I N A T I O N

BY MR. MEYER:

Q. Turning first to the discussion around benchmarks, I'm going to refer you to Exhibit Number 5, which is a sample daily log, and I'll use the illustrative exhibit here so everyone can follow along.

JUDGE MACE: I'm not sure we'll be able to follow along that well.

Q. Does that help you? Well, it's that guy, it's that one. It's Exhibit Number 5. Okay. I'm going to ask you some questions in terms of the discussion around benchmarks and transparency and auditability, a variety of questions in that area.

First of all, let's be clear. Are there benchmarks in Tiers 1 and 2, and what are they?

A. Yes. In Tier 1, as I mentioned before, the benchmark is really the market at the time that the decision is made to fix the price, and that information -- the benchmark is really set by the broker quotes and other information available, which tells you what the market price is, and that is documented. So you can compare the price that's fixed against that.

On Tier 2, it is the first of month index, and so in that sense, the price you're going to pay and the benchmark or the index is one and the same.

Q. And Tier 3?

A. Tier 3 --

Q. What is the benchmark?

A. Yes, the benchmark there is the first of the month index, and so you compare the daily purchases against the first of the month index.

Q. All right. Now, in terms of auditability, which was an issue raised by Chairwoman Showalter, how are those three tiers auditable?

A. For --

MR. TROTTER: Excuse me, Your Honor. This is pretty much direct recitation of their direct testimony, so I'll just make a formal objection that it's asked and answered.

CHAIRWOMAN SHOWALTER: I think it clarifies what I was asking.

JUDGE MACE: We'll allow the Witness to

answer.

THE WITNESS: For Tiers 1 and 2, it's very straightforward in terms of auditability, because in both of those instances there will be specific contracts in Tiers 1 and 2 that will go into a file that the Utility can look at and Staff and others can also look at and audit. So there those are very straightforward.

Tier 3, again, you will have the actual loads of the Utility versus the previously-estimated loads, so that will be very straightforward to audit. And then the pricing will be based on the Avista Energy actual transactions from the respective supply basins, and all that information will also be available to audit, as well as a comparison to the gas daily index, which is also a measure of what the market is on those specific days, so --

And we will actually prepare this daily log to document all the transactions that occur on a daily basis, whether it's Tier 1, Tier 2, Tier 3, also storage optimization, capacity optimization, basin optimization. So every transaction that occurs every day will be documented through this daily log so that the information is clearly available to audit.

Q. Okay. I want to -- I wasn't sure if you misspoke yourself or not, but you were asked, I believe by Staff Counsel, as to whether or not there was a benchmark for Tier 1 and 2 for Avista Energy to meet or beat, and what is your answer?

A. Well, there's a benchmark, and I may have misspoke, but there isn't a sharing on the 1 and 2. And the reason that there isn't a sharing is because the purpose of those to begin with is to fix the price for a portion of the portfolio to provide price stability. But as I mentioned before, there are benchmarks, but not sharing on those two pieces.

Q. Turning now to the colloquy around anticipated transportation release revenues, capacity release revenues, why do you believe experience to date with respect to transportation release or capacity release revenues may not be indicative of the future?

A. There are a number of changes that, as I mentioned before, you can't really look at the past to dictate the future, but one example is a contract with Clark that ends in the next 12 months, or actually the terms of the contract changes, which may change the opportunity there, as well as change things like changes in load. There are changes --

for example, there have been some upgrades to some other pipelines which will affect the prices between the different supply basins, so all of that has to be factored into the opportunity to the future to either gain revenues from capacity release or off-system sales. And Mr. Gruber and Mr. D'Arienzo can speak to that in more detail.

Q. Next, with regard to storage and the discussion around synthetic scheduling, why should the 80/20 sharing mechanism be applied across the board, even with respect to storage and the use of synthetic schedules?

A. Right, the important thing on here, once you have incentive mechanisms, it's important to make sure that the incentives are causing Avista Energy to do the things that are good for customers. And by having 80/20 for the storage both on the summer-winter, as well as the daily, across all the pieces, then they don't have the incentive to do something that's contrary to the interest of the Utility. They have an equal incentive across all the pieces to do what's right for the Utility's customers.

Q. So is it your testimony that notwithstanding the use of synthetic schedules, that there's still a need for an 80/20 sharing with respect to storage?

A. Yes.

Q. The subject of basin weightings was discussed. Why does the company believe it is not advisable to change the basin weightings after they are set early in a year?

A. Right. Once you set the basin weightings, it really provides a foundation for the other transactions that will be layered on top. When you set the basin weighting percentage, then that gives an indication of the available transportation that can be used for either basin optimization, where you're taking advantage of the price spreads between two different supply basins, or release of transportation.

And once you start layering those basin optimization and transportation arrangements on top, then you really can't unwind or change your basin weighting percentages; otherwise you're undermining those other transactions. And the way the benchmark is set up, once you set those percentages, then 80 percent of any of those basin optimization or transportation arrangements goes to customers. And so even though there might be a desire to change percentages, the customers are actually going to get

80 percent of any value that's going to move across time anyway.

Q. What impact would changing the basin weightings, say, twice a year or say make a mid-year correction have on your ability to do long-term capacity releases, for example?

A. It makes it difficult to do longer term capacity release, because if you're going to change the basin weighting percentages, then it may eliminate some transportation that was otherwise available for long-term. So -- and again, Mr. Gruber and Mr. D'Arienzo can speak more to how it creates difficulties.

Q. Compare the value of longer term capacity releases vis-a-vis shorter term.

A. Right. Longer term tends to have a greater value than the shorter term releases.

Q. Turning now to the discussion around the policy statement, what do you understand to be the purpose behind this Commission's issuance of a policy statement on incentive mechanisms?

A. Yeah, I think that the policy statement really was intended to promote some innovative thinking around better ways to do gas procurement and to try to derive more benefits, and I think the mechanism really has accomplished that. It's been refined over the past four years. I think it is better than what it used to be, but I think it works very well, actually.

Q. Is it meant to be prescriptive?

A. No. On the first page of the document, it says very clearly that the principles that are laid out in there are not fine-tuned to the point to where they're binding, either on the Utility or the Commission at this point.

Q. In your estimation, has the benchmark mechanism, as it has evolved through time, been shown to be flexible to respond to changing conditions?

A. Absolutely. There's been a number of changes that have been made, both where the company has come to request changes of the Commission, as well as the discussions that have taken place over the past three years with Staff and the other parties. I think it's resulted in refinements that have improved the mechanism.

Q. There were questions about what happens if or were this mechanism to be terminated. Suppose, for example, that the Utility were to bring in-house the very same individuals that were working at Avista Energy in order to perform this function and otherwise do away with the benchmark mechanism. Do you think the Utility could do as well, and why or why not?

A. No. Again, as I mentioned earlier, Avista Energy has used the analogy of a Wal-Mart, where they do tremendous amount of volume, have lots of contacts with other suppliers, which the Utility would not have with the lower volume that we do. So even though you brought in the traders or marketers to do that, unless a decision's made to do those volumes, then you wouldn't be able to achieve the same kind of savings.

Q. And do you understand that Mr. D'Arienzo will speak later in his testimony to the scale, scaleability, if you will, of Avista Energy --

A. Yes.

Q. -- versus the Utility?

A. Yes.

Q. Nearing the end here. Beyond the management fee, I think we discussed the $900,000 management fee, and the extent to which it does or doesn't even cover costs. Beyond that, is it true that Avista Energy can't make a dollar unless Avista Utilities' customers make $4?

A. That's right. The way it's set up is Avista

Energy really doesn't make money unless Avista Utilities makes money. It's set up so that for every one dollar they make, Avista Utilities receives four, so in that sense, we want them to succeed, because customers get four out of the five.

Q.   And lastly, do you believe the $3 million guarantee on transportation capacity release and off-system sales represents the right number by way of a guarantee?

A.   I think it does, and that's one of the issues that there's been a lot of debate around, is what is the right number. And from our perspective, I'm speaking for the Utilities, I think it's important to provide the party doing the business for you a meaningful incentive to do -- to get the value for you. And to put a number out there that they can barely reach really doesn't provide the incentive or reward them for a good job.

The way it's set up, you would have the first three million, 100 percent going to the Utilities' customers. Beyond that, there's an 80/20. And I think I used the example if you had a $6 million -- if they achieved that level, then really Avista Energy would get about 600,000, which is about 10 percent of the overall value, which isn't a lot when you compare the value that they're adding to the whole mechanism itself. So I think the incentive needs to be meaningful enough for them to do a good job for us.

MR. MEYER: Very well. That's all I have. Thank you.

JUDGE MACE: Mr. Trotter, anything further?

MR. TROTTER: Just a few. Thank you.

R E C R O S S - E X A M I N A T I O N

BY MR. TROTTER:

Q. Could you go to the page -- Exhibit 2, page one chart, Mr. Meyer? Could you go back to that very first chart?

MR. MEYER: Sure.

Q. Thanks. With respect to equal incentives across all components, is it true that if Avista Energy has a choice between making a transaction in the transportation component or a transaction based on the basin optimization component, there is a different incentive, because it must guarantee the first three million of transportation revenue, but has no guarantees with the basin optimization revenue; is that correct?

A. That's correct.

Q. The PGA tariff filing that the company made this fall was suspended by the Commission, was it not?

A. Yes.

Q. And do you believe Avista Energy should be rewarded for an average job or a good job?

A. Well, I think they should be rewarded for a good job.

Q. With respect to the daily log, and that was another exhibit. Since I can't read it from here, I'll just ask about it. It is Exhibit 5. Nowhere on that log does Avista Energy report Avista Energy's sales and purchases that do not use transportation of Avista Utilities; is that correct?

A. That's correct.

Q. And the daily log also does not report the effects of Avista Energy's daily balancing of its total portfolio with regards to Tier 1 and Tier 2 gas, does it?

A. That's correct. Neither one of those affect the Utility.

Q. And neither of those are captured under the mechanism, are they?

A. That's correct. There's no value provided to the Utilities' assets and no values credited back to customers.

Q. Is there value provided to Avista Energy by it being able to use Tier 1 and Tier 2 gas to balance its total portfolio on a daily basis?

A. I think, as we've talked before, it's roughly three percent of the load, so it's pretty small, pretty immaterial.

Q. So are you saying that Avista Energy is indifferent to being able to have access to Avista Utilities' storage, LNG, and pipeline capacity?

A. I don't think they're indifferent, but I think you look at the package deal where Avista Utilities is looking at a benefit of 2.6 million and Avista Energy one million from the deal. And there are other pluses and minuses in there that you can look at, also.

Q. You were asked whether the mechanism is flexible to respond to change conditions, and you referred to refinements in the mechanism over time. Do you recall that?

A. Yes.

Q. Each of those refinements was done through tariff changes, was it not?

A. I believe that's true.

MR. TROTTER: That's all I have at this

time. Thank you.

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: Just a couple, Your Honor.

R E C R O S S - E X A M I N A T I O N

BY MR. CROMWELL:

Q. Mr. Norwood, as you've reviewed here today, there is no sharing around Tier 1 or Tier 2; correct?

A. That's correct.

Q. And thus there are no consequences, either reward or loss, to Avista Energy regarding Tier 1 or Tier 2 decisions; correct?

A. That's part of the design, that's correct.

MR. CROMWELL: Thank you. Nothing further.

JUDGE MACE: Thank you very much. You're excused.

THE WITNESS: Thank you.

JUDGE MACE: I'd like to take a 15-minute recess, and then we'll resume with the next witness.

MR. MEYER: Thank you.

(Recess taken.)

Whereupon,

ROBERT H. GRUBER,

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

JUDGE MACE: Please be seated.

MR. TROTTER: Good afternoon, Mr. Gruber.

JUDGE MACE: Well, let's -- I'll let Mr. Meyer present him briefly, and then --

MR. MEYER: Appreciate your eagerness, though.

MR. TROTTER: Go right ahead.

MR. MEYER: It will be just a moment. Excuse us.

THE WITNESS: Sorry.

MR. MEYER: That's all right.

D I R E C T   E X A M I N A T I O N

BY MR. MEYER:

Q. For the record, please state your name and your employer.

A. My name is Robert Gruber. I am manager of gas supply for Avista Utilities.

Q. And have you prepared exhibits that have been marked and entered as Exhibits 51-T, 52, 53-T, 54, 55-C and 56?

A. Yes, I have.

MR. MEYER: With that, he is available for cross.

JUDGE MACE: Mr. Trotter.

MR. TROTTER: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. TROTTER:

Q. Mr. Gruber, I'd like to start with some questions that Mr. Norwood deferred to you.

A. Okay.

Q. And the first is with respect to the gas daily index. Is that an index that adds up all trades by all traders in the market for that day and averages them and reports that as an index?

A. Yes, it does. It also provides a range, but the gas daily average is the index that we're talking about, yes.

Q. And with respect to Avista Energy basically performing at the average gas daily index, you're talking about the average, not the high or low end of the range?

A. That's correct.

Q. Mr. Norwood testified in his direct that Avista Energy has been able to pool Avista Utilities' supply storage and transportation arrangements with its own portfolio. That is, Avista Energy's own portfolio. And my question to you is are you aware of that?

A. Yes.

Q. And what benefits does that confer on Avista Energy?

A. Benefits to Avista Energy?

Q. Yes.

A. I think the arrangement provides information to Avista Energy about what's happening with the Utility, that is, what happens with Utility loads. It is a very small portion of their overall portfolio, as testified by Mr. Norwood, about three percent of the physical. So the benefits of the benchmark mechanism itself, including the agency fee and sharing and all that, is the benefit.

Q. No, I'm focusing totally on the usefulness of Avista Utilities' supply, storage and transportation arrangements --

A. Okay.

Q. -- to assist Avista Energy in balancing its own portfolio on a daily basis.

A. It's a very small portion of their portfolio.

Q. So it's no benefit to AE, in your opinion?

A. I wouldn't say it's no benefit, but it is three percent of their physical volume, so it is a

small portion of the business that they do.
Q. I asked Mr. Norwood a question about capacity release revenue under the mechanism, and I asked whether the bulk of that revenue came from capacity release transactions that Avista Utilities made before the mechanism went into effect. Can you answer that question?
A. The capacity release revenues are a major portion of the combined capacity release off-system sales. Capacity releases that occurred prior to the mechanism in 1999 have tracked through, but there have been many changes in the capacity release structure. We've had a number of customers leave the system that had capacity releases that are no longer in business, we have contracts that have been renegotiated since 1999.
Q. And would all those have been renegotiated without participation by Avista Utilities?
A. Avista Utility would have participated in the negotiation.
Q. Would Avista Utility be a signatory on any renegotiated capacity release contract?
A. All of the capacity release contracts are from Avista Utilities' transportation assets, or the contracts they hold with the various pipelines, and

so Avista Utilities is a signatory -- essentially a signatory on all transportation capacity releases.

Q. Even though this took place after the mechanism went into effect?

A. Yes, it may have been structured by Avista Energy, but we are a signatory.

Q. Do you know the amount of excess pipeline capacity that Avista Utilities has available in excess of its average load? And I'm referring to pipeline capacity, storage, and LNG?

A. On a design peak day or on an average day?

Q. Both.

A. No, I don't have that number at my fingertips.

Q. I asked Mr. Norwood about the tariff that addressed the setting of the basin weightings, and the tariff called for Avista sending its calculation to the Commission in January, and in February the Commission making a decision on that, or at least a decision on that by February 1st. Do you recall those questions?

A. Yes.

Q. And what kind of decision are you contemplating by the Commission?

A. What has occurred in the past is

communication between myself and members of the Staff. I don't believe we've ever received a formal ruling from the Commission about the establishment of the basin weightings.

Q. And you don't anticipate any change in that?

A. If the Commissioners want to make a ruling on whether or not the basin weightings are correct as proposed each year, that's fine with us. It's -- that's their call. I mean, I can't make that.

Q. Yeah, I'm asking the call you made by putting the word Commission decision in the tariff. And from what I can tell, you're just referring to informal contact with the Commission Staff?

A. That's -- that has been our relationship so far.

Q. Before the benchmark mechanism went into effect, did Avista Utilities purchase peaking resources to serve its peaking needs?

A. Yes, it did.

Q. And there was some discussion regarding Bench Request Number 1. Can you refer to that, please?

A. Yes.

Q. And some of the discussion centered on the year 2000, in which Avista Energy apparently lost

$8.3 million in the peaking area. Do you see that?
A. Yes.
JUDGE MACE: Hold on for just a second. Have you got that in front of you?
THE WITNESS: I have.
Q. And I asked Mr. Norwood what changes were made to the mechanism following that event that minimized the risk that AE experienced in that year for that item.
A. For which specific item are you referring?
Q. The $8 million peaking loss in the year 2000.
A. Okay. The changes that we recommended do not come until 2002, at the end of the first benchmark mechanism, and we restructured the mechanism to include not only hedging, but a sharing of costs in the tiers. That is, Tier 1 -- actually, the current has four tiers, which the fourth tier is what I would call extreme peaking, where we would use storage or day purchases. But it allows the Avista Energy to avoid the risk that it incurred in 2000 for the day purchases by sharing in the necessary day purchases in Tier 3 and Tier 4. That is, the Utility -- or I'm sorry, the peaking supplies are handled out of gas daily or storage.

Q. I also pointed Mr. Norwood to three of the company's quarterly reports on the mechanism.

A. Yes.

Q. And I believe those were Exhibits 19 through 21. And it showed losses in the --

MR. MEYER: Excuse me. Can we get to those?

MR. TROTTER: If he needs them, he's welcome.

JUDGE MACE: Which exhibits were they?

MR. TROTTER: Nineteen, 20 and 21.

THE WITNESS: Okay.

Q. It showed losses in the Item Seven, and I believe those are storage-related; is that correct?

A. That's correct.

Q. And I focused on, for example, Exhibit 20 showed a $908,000 loss in that category, and there was a loss in the following exhibit for the next quarter of $716,000. My question to him was, and now to you, did those losses generate any changes in the way the mechanism was managed or structured?

A. Those losses were a result of changes that had occurred in the way we managed the mechanism. Under the very first mechanism that was in place from 1999 to 2002, we came to the Commission and asked to be able to defer costs for hedging program. The hedging program began at the Utility. It was not part of the benchmark. We didn't change the benchmark mechanism as they existed at that time, and the Utility did the hedges for 2001 through 2000 -- or fall of 2002. Some of those costs are reflected in the losses -- in the storage losses, because some of the storage volumes were hedged in early 2001, on annual contracts.

So we had some fairly high costs of hedged volumes going into storage that ended in 2000 -- the summer of 2002, and fell into this period for withdrawal in 2002-2003 winter.

Q. My question was whether those losses led to any changes in the mechanism as it was structured or operated. So let me ask, did it make any changes -- result in any changes to the way the mechanism is structured?

A. Yes, we changed the structure of the mechanism in 2002, to reflect a hedging program as part of the -- as part of the mechanism.

Q. And how about with respect to the way the mechanism was operated before that structural change was made?

A. No.

Q. Turn to your rebuttal testimony, Exhibit

53-T, page three.
A. Which page?
Q. Three.
A. Okay.
Q. Here you show a table comparing your analysis of net benefits to the Utility -- or net costs, excuse me, to the Utility if procurement operations were to return versus Staff's analysis of the net benefits; is that right?
A. That's correct.
Q. And the largest difference is obviously line 18, 19, the estimated loss of transportation benefits; is that correct?
A. Yes.
Q. The gas market has changed since the benchmark mechanism went into effect in 1999; correct?
A. Yes, it has.
Q. And even since 1997, Avista was looking for ways to make better use of its unused capacity by way of off-system sales and other measures; correct?
A. Correct.
Q. Would it be fair to say that, absent the benchmark mechanism, Avista Utilities would be operating differently in managing its gas portfolio,

including its capacity rights, than it did before 1999?

A. I guess that's correct.

Q. One of the differences would be improved management of its unused capacity; correct?

A. It would be management of its unused capacity. I don't know if it would be improved. It would be different.

Q. Do you anticipate that the Utility, if it had been operating its own gas procurement today, would be doing a worse job than it was doing in 1999?

A. No.

Q. Turn to Exhibit 55-C. And this is the company's backcast, if you will, an estimate of how the proposed mechanism would operate if it had been operating in the same form since September of '99 through February '03; correct?

A. Correct, as it is proposed in -- today.

Q. And this is confidential, so --

JUDGE MACE: Actually, I believe that it's been -- not confidential. That I thought was what Mr. Meyer --

MR. MEYER: I'm sorry, I couldn't hear.

MR. TROTTER: 55-C is still confidential, isn't it?

MR. MEYER: Yes, it is.
CHAIRWOMAN SHOWALTER: Just the bottom line figures.
MR. TROTTER: Certain of the bottom-line figures.
Q. So for ease of reference, there's one box that occupies about the top half of the page, do you see that?
A. Yes.
Q. And in the right-hand lower corner, there's two stars or asterisks. Do you see those?
A. Yes.
Q. And right above that is a figure, and it's AE actual model P&L annual average. So it's the bottom right-hand corner figure in that box?
A. Yes.
Q. And that's Avista's estimate of the annual average benefit to AE from the mechanism as it is proposed; correct?
A. Yes, that's correct.
Q. And Mr. Norwood called that figure in his nonconfidential testimony approximately $1 million; correct?
A. That's correct.
Q. And that's the same one million you're

referring to in your testimony; right?
A. Yes.
Q. Just as an overview, the first third of the box calculates the total system profit and loss from the mechanism and the remaining two-thirds split that total between the Utility and Avista Energy; correct?
A. Yes, but it is not additive, because there are a number of things in the top box that are Avista Energy only and a few things that are Avista Utilities.
Q. Okay. The first item I want to talk about in the upper third is the line entitled peaking benefit. Do you see that line? It's the --
A. Yes.
Q. -- seventh line down?
A. Yes.
Q. And it's your testimony that the Staff double counted the storage peaking benefit in its analysis. Is that your testimony?
A. Yes, it is.
Q. And in your testimony, and I can give you the cite if you need it, but you stated that the storage peaking benefit was included by the company in one of its work papers, and that's -- this is the work paper; right?

A. Yes.

Q. Staying with that peaking benefit line, the total amount is shown under the total column for that line; correct?

A. You mean the total amount of the peaking benefit is included in the total system P&L?

Q. No, I'm saying the total amount for peaking benefit is shown under the total column for that same line. It ends in 484.

A. Okay.

Q. Is that correct? That's the --

A. Restate that. I was not looking at the same number you were looking at.

Q. The total peaking benefit amount --

A. Correct.

Q. -- is the figure shown in the total column of that line, peaking benefit line, and it ends in three digits, 484; correct?

A. Correct.

Q. Okay. I'd like you now to refer to Exhibit 62-C, but keep an eye on that figure, because it's going to match up. I'll ask you if it matches up.

A. In 62-C?

Q. Yes. It's your response to Staff Request 19 B and C.

MR. MEYER: May I approach the Witness?

JUDGE MACE: Yes.

THE WITNESS: I have it.

MR. MEYER: Okay, good.

Q. Okay. The question, in part, asked for the fair market value of Avista Energy's use of Avista Utilities' gas storage capability under the current and proposed benchmark mechanism; is that right?

A. Correct, yes.

Q. And I'm trusting that the response to that item is not confidential, but the answer is that no such calculation was made; is that right?

A. Just a moment. I'm rereading the response.

Q. It's the third sentence.

A. In this context, that's correct.

Q. Now, that response was specifically that Avista Energy had made no attempts to calculate that value. And my question to you is, since the request was not limited to Avista Energy's calculation, are you aware of any calculation by Avista Utilities or anyone else of the fair market value of Avista Energy's use of the Utility's gas storage capability under the current or proposed mechanism?

A. No, I'm not aware of any calculation.

Q. Turn to page four of the exhibit. And there was that total peaking benefit figure from Exhibit 55-C, and that same figure is shown on this page in the -- right on the first line, under Tier 2 and Tier 3 column; correct, that ends in 484?

A. Yes, same number shows there.

Q. Okay. Am I correct that this analysis in Exhibit 62-C is essentially the company's look at the period the mechanism was in place in determining the number of days in which storage could be used to meet daily peaking needs, and then the stored volumes could be replaced at a future time at a price less than the current day's index?

A. Yes.

Q. And so this page shows for each entry the number of days over the three and a half years the mechanism was in effect that it was possible to pull gas from storage to meet peak day needs beyond the synthetic schedule and replace those volumes later at a lower cost?

A. That's correct.

Q. And if we count those days, we would get 41 days. Can you accept that subject to your check?

A. I thought it was 36 days.

Q. Thirty-six. Do we just count the number of figures in that column that have a number in it other than zero? I mean, maybe it includes all of them.

A. I think it includes all of them.

Q. Okay.

A. I'd have to recount it, but I believe it includes all of them.

Q. I'll ask you to accept that there are 41, subject to check, and there are procedures for you correcting that if we're wrong.

A. Subject to check, yeah.

Q. Okay. Now, the analysis in Exhibit 62-C which gave rise to the figure that appears in Exhibit 55-C only considers using storage to meet peaking requirements; correct?

A. 62-C was an analysis of the number of days you could utilize storage to meet peaking requirements and replace it later at a lower cost.

Q. And that is what gave rise to the figure that ends in 484; correct?

A. That's correct.

Q. Let's go back to Exhibit 55-C. And I would like to discuss the line still in that big box for currency, which is shown under Part A, Avista Utilities' share, and Part B, Avista Energy's share. Do you see those lines?

A. Yes.

Q. And this shows basically the impact of the exchange rate between the U.S. dollar and the Canadian dollar for the period the mechanism has been in effect through February '03; correct?
A. Yes, the currency valuation on an annual basis was provided in a study to -- on a data request back in December, I believe, to Staff, but the figure that is shown there on an annual basis is that estimate.
Q. Turn to your rebuttal testimony, Exhibit 53-T, page 12. And on line 18, you refer to --
CHAIRWOMAN SHOWALTER: Can you just wait till we -- one moment.
MR. TROTTER: I will. Sorry.
CHAIRWOMAN SHOWALTER: Line what?
MR. TROTTER: Line 18.
Q. And here you testified that in the 12-month period, August 1, 2002 through August 1, 2003, the Canadian currency strengthened against the U.S. dollar by about 8.6 cents; is that right?
A. That's correct.
Q. Please refer to Exhibit 63.
A. Okay.
Q. And this exhibit shows the currency exchange rates from August '99 through August '03; correct?

A. Yes.

Q. Now, if we look at the exchange rate change for the same period you used in Exhibit 55-C, which would be September '99 through February '03, there was a net reduction of 1.52 cents, and that's calculated by taking the September '99 exchange rate of 67.31 cents minus the February 2003 rate of 65.79 cents; correct?

A. September '99 through February of '03?

Q. Yes.

A. It would appear to be correct, yes.

Q. And you note in the last line of this Exhibit 63 that there can be significant exposure to currency shifts during each year in both directions. Do you see that?

A. Yes.

Q. Is that a correct statement?

A. Yes.

Q. Now, the difference between Staff and company on the currency issue is that the company predicts a net cost to the company, meaning Canadian dollars will be more expensive going forward, while Staff's -- compared to the dollar, while Staff's position is that currency shifts go each way, so a net of zero should be used. Is that a correct

statement?
A. That's correct.
Q. Does Avista or Avista Energy play the currency exchange markets?
A. Do we play the currency exchange market?
Q. Yes.
A. I know that Avista Energy deals with the currency exchange, and I presume they do that through financial tools, but I don't have full knowledge of what they do.
Q. Does Avista Utilities do it?
A. Not currently. Not for gas supply out of Canada.
Q. If you were predicting a persistent premium of the Canadian dollar versus the American dollar, you would be buying Canadian dollars in large amounts, wouldn't you?
A. A premium in Canadian over the U.S.?
Q. Yes.
A. I presume I would be. I am not an exchange specialist, though.
Q. Let's go back to your rebuttal testimony, Exhibit 53-T, page 15.
A. Okay.
Q. And here you're responding to testimony from

Public Counsel's witness, but you say, on lines 10 through 15, you're referring to the FOM price for Tier 2 and the use of the FOM index in Tier 3, and you conclude -- you also talk about the 80/20 sharing in Tier 3. And on line 12, when you talk about savings and cost above and below that point are shared 80/20, you're only referring to Tier 3, are you not? You're not referring to Tier 1 or Tier 2 for that testimony, are you?

A. I'm referring to the difference between the performance in Tier 3 to the first of month index, which is established in Tier 2.

Q. Okay. But Tier 1 and Tier 2, there's no sharing 80/20?

A. No.

Q. Okay. And you conclude that Avista Energy clearly has an incentive to save the customers money because they have an opportunity to share in the 20 percent of the savings and are at risk for 20 percent of the cost of the benchmark; correct?

A. Yes.

Q. And again, you're referring to Tier 3?

A. Tier 3.

Q. Only?

A. Yes.

Q. And do you agree with Mr. Norwood and Mr. D'Arienzo that Avista's Energy's purchases in Tier 3 have been virtually the same as the gas daily index?

A. That Avista Energy has been able to perform that index, yes.

Q. It hasn't beaten that index, has it, consistently?

A. Not by a significant amount in the period that was studied here.

Q. And as we discussed earlier, the gas daily index is -- the average index price is simply the average of all transactions that occurred on the prior day; is that right?

A. Yes.

Q. And the way that the mechanism works, if that -- effectively, since Avista Energy's purchases have been at that average index price, if Avista Energy continues to purchase at about the average gas daily index price and the gas daily index happens to be below the first of the month index, there's a benefit, and if it's above the first of the month's index, there's a cost; is that correct?

A. That's correct.

Q. Please refer to Exhibit 64. This is a data request that asks you to explain why it's appropriate to enter into hedges based on the basin weightings in place regardless of the price at the individual basin; is that right?

A. Yes.

Q. And part of your explanation is that the hedges Avista enters into are based on the basin weightings, because those weightings are limited by physical capacity out of each basin; is that right?

A. That is correct.

Q. And essentially the way this is working is that if the basin weightings are, say, for example 64 percent AECO, 18 percent Sumas, and 18 percent Rockies when a hedge is placed, let's say for 5,000 therms per day, then the hedge is split for that 5,000 therms 64 percent to AECO and 18 to the other two?

A. Yes, we try and match those up. You reach a point where we do it in -- try to do it in big enough blocks that you have blocks that can be transacted. Some are so small that they can't, but --

Q. And so that means that 64 percent of the 5,000 decatherms would be priced at the AECO hedge price, 18 percent at the Sumas hedge price, and 18 percent at the Rockies hedge price?

A. Yes, that's the target.

Q. So if the hedge price at the Rockies is attractive, but the hedge prices at the other two basins are not, the company will not enter into a hedge at just the Rockies; is that right?

A. When the Strategic Oversight Group sets targets for hedges within a time frame, they establish the values that we're trying to hit based on what's happening in the market. And Avista Energy's goal is to meet those targets. Generally, you will end up with hedges as you've described. You will hedge some in the cheapest basin and some in more expensive basins.

Q. So the company will enter into a hedge just at the Rockies if it's attractive to do a hedge there, rather than all three?

A. If we can stay within the time frame. If we think the other basins are going to move, that is, shift in price in the near term, you may end up hedging in the Rockies, but in the overall, at the end of the day or at the end of the period, which may be a week or two, you will have hedged 68 percent -- 64 percent at AECO in your example, 18 percent in the Rockies, and 18 percent at Sumas.

Q. So you don't do an individual hedge just at the Rockies, for example?

A. We do individual hedges at the Rockies, but we try and meet the targets of the percentages of the basin weightings.
Q. I guess I'm not understanding the response. If you enter into a hedge just at the Rockies, does that mean there's no corresponding hedge at the other two basins or that you would make a corresponding hedge at the other two basins?
A. No, on a short term basis, you may have a situation where you've placed the Rockies' position, but you have not yet placed others. You will eventually place those.
Q. Okay. So there might be some short term --
A. Yes.
Q. -- when you would have a hedge only at the Rockies, but eventually the other two will match up?
A. Yes.
Q. Has Avista Energy ever done just that?
A. On a short-term basis, I'm sure they have, yes.
Q. Now, entering into a hedge just at the Rockies without a corresponding hedge at the other two basins is not barred by the proposed mechanism, is it?
A. No.

Q. With respect to the basin weightings in the mechanism, it's possible, if more gas is available at a particular basin than the weightings suggest, that AE can exceed those weightings in one basin; is that right?

A. Not for hedges. Hedges are done at the basin weightings because that is the amount of capacity that is available on a peak day to deliver. The activities in the basin to capture the value of the transportation and/or lower commodity cost in the Rockies, in your example, happens under the basin optimization part of the program.

Q. Let me ask it this way. Let's assume that the basin weighting is established for the year at Rockies of 18 percent.

A. Okay.

Q. But under the mechanism, AE can go as high as 25 percent in that basin, can it not?

A. If the -- if the basin weightings are established at 18 percent in the Rockies, Avista Energy would not go above the 18 for hedges.

Q. But it can buy gas up to 25 percent at the Rockies under that scenario, can't it?

A. If the capacity is available.

Q. And that is the maximum permitted by the

tariff based on capacity available, is it not?
A. That is correct. But the capacity available, if it is being unused today, is utilized either in off-system sales, capacity releases or basin optimization.
Q. Please state why hedges could not be entered into at a 25 percent weighting based on the capacity, though the weighting under the mechanism is 18 percent if prices are favorable to do that transaction, and then adjust the other weighting percentages accordingly.
A. Because, under the mechanism, the pricing to the Utility for the Tier 2 volumes are -- is established at the basin weightings. And if you have hedged a greater percentage in any one basin, you're financially exposed to the differential in price between the basins. You went long in the Rockies and you're required to deliver -- you went 25 percent in the Rockies and you're required to deliver 18 percent out of Sumas, the price differential between Rockies, if it shifted, Avista Energy would be exposed to the difference in price.
Q. And changing the weightings under the mechanism would also have the effect of reducing -- for example, if you increased the weighting of one

basin that turned out to have very attractively priced gas compared to another basin, that would have the effect of lowering the basin differentials available under the mechanism, correct, because now you're rebasing the basin price?

A. Could you restate that?

Q. Yes.

A. I'm not sure I followed you.

Q. Let me start over. The basin differentials, once they're established, set forth the basis for calculating basin differential benefits; correct?

A. Yes.

Q. And so if, as the mechanism is actually operated, Avista Energy uses one basin at a higher level than the mechanism prescribes for the basin weighting, that can give rise to a basin differential and a benefit to AE and Avista Utilities' customers; correct?

A. Yes.

Q. And if you rebase that basin percentage midstream, that basin differential would disappear, wouldn't it, if you rebased it to reflect the new weighting?

CHAIRWOMAN SHOWALTER: Mr. Trotter, can you just explain to me what you mean by rebase, so I can understand what the answer is and what time you're talking about?

Q. Yes, the rebase -- let me just start over again. I'm sorry. What I'm trying to get at is that the basin weighting is set in February. And if Avista Energy is able to say 18 at Sumas, and Sumas turns out to be a very low-priced basin after February, Avista Energy has the discretion to buy more than 18 percent of the gas at that basin; right?

A. Yes.

Q. And if it does, then that will cause a basin differential benefit to occur, wouldn't it, that would be shared under the mechanism between Avista Energy and Avista Utilities?

A. 80/20.

Q. Now, if instead the basin weighting is changed to reflect that new updated basin weighting based on the attractive price at Sumas, then the basin differential would be eliminated, because you're no longer comparing it to what was set in February; you'd be comparing it now to the updated actually-used percentage; correct?

A. You would establish a new basis under which your hedging program should be structured midstream. That is, in October or November, whenever you changed it. You would change your basis or your basin weighting at Sumas to 25 percent in the example, as I recall, and in so doing, to avoid financial exposure, you would have to change your hedging structure. It would also have an impact on customers, but you would have to change your hedging structure to 25 percent at Sumas in October.

You also -- so you're basically hedging at the beginning of the heating season, which historically is not the best time to do that.

Additionally, you would -- I won't say destroy the ability, but you certainly hamper the ability to do long-term releases and intermediate term for the season releases at the various basins based on where you had established your original weightings.

Q. Now I'd like you to answer my question.

A. Okay.

Q. And that was wouldn't the rebasing of the basin percentage eliminate the basin optimization benefit?

A. Yes.

Q. There were a number of questions asked about the Strategic Oversight Group, and I'm going to let others pursue those. But one question I did have was when was that Strategic Oversight Group created?

A. It was created in, as I recall, in April of '02, when the current structure went into place.

MR. TROTTER: Thank you. Those are all my questions.

E X A M I N A T I O N

BY JUDGE MACE:

Q. I just wanted to refer back to a question that Chairwoman Showalter asked that sort of reflects when the Strategic Oversight Group was set up. The current benchmark in effect now, has that been operating since April of '02?

A. That's my recollection, yes.

JUDGE MACE: Thank you. Mr. Cromwell.

MR. CROMWELL: Thank you, Your Honor.

C R O S S - E X A M I N A T I O N

BY MR. CROMWELL:

Q. Good afternoon, Mr. Gruber.

A. Good afternoon.

Q. I just wanted to follow-up on one thing to make sure I'm clear on the numbers. Mr Trotter had you looking at the table one on your rebuttal testimony, Exhibit 53, and I believe that, at least for the company's part of that table, that's the same that's on your table one in your direct testimony; is that correct?

A. That is correct.

Q. So for the expense category, can you tell me how you calculated those expenses?

A. All of them?

Q. Well, I think there's -- let's take the first five, employees, credit, premium --

JUDGE MACE: Can we hold on, Mr. Cromwell?

MR. CROMWELL: Oh, I'm sorry.

JUDGE MACE: Exactly what are you referring to? I believe it's Mr. Gruber's 3-T, at page three?

MR. CROMWELL: It is, Your Honor. It is either Mr. Gruber's Exhibit 53, his rebuttal testimony, at page three, that column labeled company table per RHG-1-T, which was his direct testimony. So in other words, that data is derivative of his direct testimony, which I believe was admitted as Exhibit 51, where it can be found at page seven.

JUDGE MACE: Thank you.

CHAIRWOMAN SHOWALTER: Can you just, if we're looking at something, just tell us a page?

MR. CROMWELL: All right.

Q. How about the first instance of this data, which would be Exhibit 51, page seven, table one.

A. Okay.

Q. And I suppose, for the record, was I correct in my assertion, Mr. Gruber, that the data in your rebuttal testimony on table one that you discussed with Mr. Trotter a few moments ago is in fact the same that you came up with for your direct testimony?

A. That is correct.

Q. All right. And for those first five expenses that you have there, employee credit, premium for delivery, currency and load volatility, can you tell me how you came up with those figures?

A. Yes, in general terms, the figures are subject to calculation in various work papers, but the first figures employ loaded labor costs. That represents adding four employees at various levels to the Utility. Loaded for, you know, labor cost, loaded for benefits and some ancillary services like computers and office space. That's the $408,500 number.

Credit of 512,500 is our estimate of the cost of a credit facility to allow the Utility to post collateral for purchases for the gas procurement program on the commodity side.

Currency was based, the 176,000 in currency was based on an earlier study that determined, over a period of time, it was actually prior to the 2002 time frame, the credit or the -- I'm sorry, the exchange exposure at AECO for purchases that the Utility makes at AECO in U.S. dollars or is billed in U.S. dollars that are -- the purchases are actually made in Canadian dollars.

The low volatility is the 20 percent of the -- of Avista Energy's -- it's Avista Energy's share of the 20 percent or is their 20 percent of the cost of covering that low volatility, as shown on Exhibit 55-C, I believe. That's the first five.

Q. Okay. Thank you. And can you tell me, did you perform the calculations that generated these numbers or did someone under your direction perform them?

A. They were prepared under my direction.

Q. By whom?

A. A number of people, actually. The employee loaded labor cost was prepared in our -- I'm referring now to Exhibit 55. They came under my direction, but the labor cost was a result of estimates I made and our accounting department made for the miscellaneous services and loadings. The credit was based on a study by the Utilities' credit department. The premium for physical delivery was an estimate based on a study made by Avista Energy. Currency -- Avista Energy provided some of the data. I believe that study was done at the Utility by our accounting department, resource accounting.

Q. And were all these calculations performed roughly contemporaneously with the submission of your direct testimony, or were they historical, actually?

A. These have been developed over time. They were not necessarily developed just for my direct testimony. We've been discussing how to structure the -- a revised benchmark mechanism with the Commission Staff for some time, a year and a half, roughly, and some of these numbers were developed as a part of those discussions, some were developed -- I think some may have been developed for my testimony.

Q. All right. Thank you. Do you have a copy of Bench Request 1 available to you?

A. I do.

MR. CROMWELL: And Your Honor, if I may, as an aside, Mr. Meyer, are these nonconfidential, Bench Request 1?

MR. MEYER: Yes.

Q. Okay. Mr. Gruber, I'd ask you to look down at roughly the bottom third of the table, those rows

-- I guess if we say the row AE actual total P&L is the last row, I'd ask you to look at the four above there, premium for physical delivery, currency, credit, overhead, and go over to the columns labeled 2000, 2001 and 2002. Those are the same numbers that you have in your testimony; correct?

A. Yes, they are.

Q. And those -- in the document which has been marked and I believe admitted as Bench Request 1, those are the estimates for the Avista Energy costs for those same functions; is that correct?

A. No, those -- the costs are the benefits to the Utility. That is what the Utility would experience in cost if it brought the procurement system or program back in-house. And for purposes of consistency, we show, for example, credit at 512,000 as an Avista Energy expense. I cannot say that that is their expense associated with this program.

Q. So when the title of that box, which is AE actual operation of benchmark mechanism, you're telling me now today that the numbers in the bottom there are not AE's actual operation expenses, but rather are the AU foregone expensed items; is that correct?

A. In some cases. I can't say -- I think the premium for physical delivery is probably what Avista Energy experiences for physical delivery under the mechanism as it's proposed. Actually, this is -- this is a -- an estimate of the actuals under the mechanisms that existed at the time, so -- but it is, in fact, an estimate.

Q. All right. Thank you. I'd like to turn now to page 21 of Exhibit 51, your direct testimony. And at the top of the page there --

JUDGE MACE: I'm sorry, which page?

MR. CROMWELL: Page 21.

JUDGE MACE: Thank you.

Q. And at the top four lines there, is it accurate, Mr. Gruber, that you describe the difference in benefit sharing between the current mechanism and the proposed mechanism?

A. Yes, with respect to the $3 million guarantee that's proposed with respect to capacity release/off-system sales.

Q. And that's -- in your testimony, you refer to that as the transportation component; correct?

A. Yes.

Q. And would you agree that ultimately it's a question of judgment for this Commission to determine what the appropriate sharing of benefits for transportation should be?

A. Yes.

Q. I'd ask you now to turn to Exhibit 53, your rebuttal testimony, at page five. And if you would refer to lines nine through 13.

A. Yes.

Q. And there you suggest that Ms. Elder had made an error in her calculation of capacity release and off-system sales; is that correct?

A. Yes.

Q. Would you recognize that the .69, or I should say 69 cents a decatherm, includes the value of off-system sales based on the company's records produced during discovery?

A. Do I understand that it's based on the company's records? I understand Ms. Elder's study was based on -- partially on information that was provided by the company in terms of the volumes that were released and/or established as off-system sales.

Q. And that was information produced by the company in response to Public Counsel data requests; correct?

A. I'd have to -- can you refer me to the data request?

Q. I could. It's actually just a foundational question.

A. Okay.

Q. If you will accept it subject to check?

A. Okay.

Q. I'd ask you now to turn to what's been admitted as Exhibit 61, and it was the company's response to Staff Data Request 132. Do you have that available?

A. Yes, just a minute. Yes.

Q. And what you produced was -- I believe it's 18 CFR Part 284.8; correct?

A. That is correct.

Q. And if I could direct your attention to subsections (H)(1), that's on the right column, second paragraph, are you with me?

A. Paragraph number two?

Q. I'm sorry, no, it's -- it's denominated (H)(1). It's (H)(1).

A. Got you, okay. Sorry.

Q. Release of capacity. If you would simply review that paragraph to yourself for a moment?

A. Okay.

Q. Let me know when you're ready.

A. I'm ready.

Q. Would you agree that off-system sales are not subject to the provision you cite in your response to the data request asking for the authority you relied upon in your testimony?

A. Off-system sales are not subject to the tariff rate restriction in 18 CFR 284.8, no.

Q. And so because Ms. Elder's 69 cents a decatherm calculation includes off-system sales, it is indeed possible for this aggregate value of capacity release and off-system sales to exceed the .27760 cap; is that correct?

A. It is possible.

Q. Okay. You also noted that the glut of capacity and low values for capacity in off-system sales --

JUDGE MACE: Mr. Cromwell, could you slow down just a little bit, please?

MR. CROMWELL: I apologize. I indulged in some soda this afternoon.

Q. Mr. Gruber, in your testimony, you also noted, I believe, a glut of capacity and low value for capacity and off-system sales --

A. Yes.

Q. -- that occurs during off-peak months; is that correct?

A. Yes.

Q. I'd ask that you refer to Exhibit 254-C if you have that available?
A. That one I don't believe I have at my fingertips.
MR. MEYER: Sorry, which one? Which exhibit?
MR. CROMWELL: It's been admitted as 254-C. It was Exhibit 4-C to Ms. Elder's testimony.
MR. MEYER: I'm still trying to find it. Now that I've got Ms. Elder's testimony, which exhibit?
MR. CROMWELL: It's 4-C, so it would be marked CME-4C.
MR. MEYER: 4-C. Got you.
MR. CROMWELL: I believe we previously admitted it as 254-C.
JUDGE MACE: That's correct.
Q. Are you with me, Mr. Gruber?
A. I am now.
Q. There's a table there, and if we look down to -- I believe it's the ninth line or row --
CHAIRWOMAN SHOWALTER: What's the name of it?
Q. Assume percent of transport recovery. Do you see that? I suppose the other way to look at it

is third up from the bottom.

A. Yes.

Q. And that line accounts for the lower values for capacity and off-system sales during the off-peak months, does it not?

A. Yes, it does.

Q. And for peak months, that line would adjust the value down by 50 percent; is that correct?

A. For off-peak months, it adjusts the value down. It appears to adjust the value down by 50 percent for off-peak months.

Q. Thank you. So it's true, is it not, that Ms. Elder, in fact, adjusted for lower value of capacity and off-system sales in off-peak months in her analysis, is it not?

A. Yes, but the total of the off-system sales and transportation capacity release value shown in this table is approximately 69 cents per decatherm, as I testified in my direct -- or my rebuttal testimony.

CHAIRWOMAN SHOWALTER: What row is that that you're referring to?

THE WITNESS: It isn't shown on a row on this exhibit. It's a calculation of the total value -- I have to go back to it.

CHAIRWOMAN SHOWALTER: Is it implicit in one of these rows?

THE WITNESS: Yeah. Well, it's a calculation of total dollars recovered versus therms released or decatherms released.

JUDGE MACE: Is there a way that it could be calculated by looking at this exhibit?

THE WITNESS: Give me just a second. Yes, I'll give you an example. Using one of 100 percent months, December, for example, if you divide the number shown as the monthly transport release off-system sales revenue, the bottom number in that column, in the December column, by the fourth number up, which is the soon available for release, divide the result of that by 31 days in December, it comes to 69.47 cents, which is consistent -- pretty much consistent throughout this. You have to adjust for the assumed percent of transport recovered.

CHAIRWOMAN SHOWALTER: Just along those lines, if you go all the way over to the right-hand side and divide the bottom right number by the fourth to the bottom right number, is that a comparable calculation? I meant third to the bottom right number.

THE WITNESS: I used the fourth.

MR. CROMWELL: Your Honor, just for clarification, are we -- we're referring to the number that ends in an eight down in that lower right-hand corner?

CHAIRWOMAN SHOWALTER: I was wondering, if you go to the bottom right-hand corner with the number that ends 797, and you divide it -- I don't know if it's into or by the number that ends with 338.

MR. CROMWELL: Okay. Just wanted to make sure everyone's on the same page. Thank you.

THE WITNESS: And you have to adjust it for 71 percent assumed percentage of transport recovered, that number would have to be weighted by the number of days in each month. It's difficult to get to it in the total column, because the percentages are different. You can't add the percentages across. But month by month, if you follow that formula, it works out to 69 cents.

CHAIRWOMAN SHOWALTER: Okay.

Q. Mr. Gruber, I'd like you to now, if we look at -- well, strike that.

If we go to Exhibit 53, and go to page 13, referring to the last six lines of that page, are you with me?

A. Yes.

Q. You suggest that if Avista Utilities were to be managing the procurement function, that Avista Utilities would be exposed to similar market conditions as Avista Energy is and would purchase gas in a similar fashion; correct?

A. Yes. Can I review real quickly the context that we lead into here? Just a moment, please.

Q. Please do.

A. Yes, I -- the Utility would be subject to similar market conditions.

Q. So that conclusion is not premised upon a hypothetical? You believe that, as a general matter, that the Utility, if it were to manage this function, would be subject to the same market conditions that Avista Energy is subject to?

A. Yes, and it would follow pretty much the same steps in terms of basin optimization, economic storage withdrawal, and following that, the Utility would end up at the same place, buying gas at Sumas in this example.

Q. I'd like you to follow me with a hypothetical for a moment. And let us first assume that the Commission rejects the Company's proposed mechanism and returned the procurement function to

Avista Utilities and placed it under your control.

A. Okay.

Q. Were you to manage that procurement function for Avista Utilities, Avista Utilities' customers would receive 100 percent of the benefit of your management; is that correct?

A. Yes.

Q. And if Mr. D'Arienzo does exactly what you would have prudently done, then there is no rationale for Avista Energy retaining 20 percent of the benefits associated with a given transaction, is there?

A. Not necessarily. The ability to acquire the gas at the same price relies on your presence in the market. I think we've testified before in this case that the advantage that Avista Energy brings to the table is the fact that they have a much larger portfolio to deal with, they're in the market every day, the Utility is in the market on a seasonal basis, so Avista Energy, in most cases, may be able to purchase gas at -- without paying some of the premiums that the Utility ends up paying doing it on -- not necessarily a part-time basis, but more of a seasonal basis. So I don't know that we would come to the same dollar result with Avista Energy as the

Utility. In fact, we would not.

Q. I understand that it is the company's position that Avista Utilities and Avista Energy face a different position in the market.

A. Mm-hmm.

Q. Let me put it differently. There is no reason to reward Avista Energy for taking a management action which you or any prudent Avista Utility gas manager would have done facing similar market conditions, is there?

A. I think there is if they can get a better deal.

Q. All right. And how would this Commission measure that increment of difference?

A. The measurement that we're recommending is the 80/20 sharing in the commodities portion of Tier 3.

Q. That isn't what you just told me. What you just told me was that Avista Energy and Avista Utilities are essentially different actors in the market. So my question to you was how can this Commission measure the increment or difference in Avista Energy's ability in the same given set of market conditions to obtain a certain deal that is some increment better than the deal which Avista

Utility could do were it to be performing the same function under the same market conditions?
A. It is very difficult to measure that increment, and what we're recommending in this case is 80/20 sharing to reward Avista Energy for what they bring to the table.
Q. So it's true, is it not, that the proposed mechanism does not, in any respect, attempt to measure the difference between -- to put it colloquially -- the deal that Avista Energy can do versus the deal that Avista Utilities could do?
A. I'm not sure I could point to any mechanism to measure that difference in this specifically.
Q. Thank you. I'd ask that you now turn to page 15 of your rebuttal testimony. And referring to lines 16 through 25 -- are you with me?
A. Yes.
Q. And here you criticize Ms. Elder's Exhibit CME-6, which has been admitted as Exhibit 256, where Ms. Elder compared Avista's commodity cost to basin weightings; is that correct?
A. Yes.
Q. Did you perform the same calculation Ms. Elder did with the basin weightings you claim were in effect during the study period?

A. I may have done a rough calculation. I don't think I have it.
Q. So you don't know whether changing the basin weightings, in fact, makes any difference at all, do you?
A. Well, it makes some difference, but I'm not sure that it was a huge dollar amount. I don't know the dollar amount.
Q. Would you agree that it's not a material difference in the result?
A. I would have to calculate it.
Q. Would you accept, subject to check --
A. Subject to check.
Q. -- that there's not a material difference --
A. Subject to check, yes.
Q. -- were you to change the basin weightings?
A. Yes, sir.
Q. Thank you. I'd like you to go to page 17, please. And at lines 22 through 24, you state, I quote, 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 quarter?
A. Correct.

Q. You don't mention here at all the .27760 a decatherm FERC cap in applying to these sales, do you?

A. No, I do not.

Q. And you'd agree, as we previously discussed, that off-system sales are not subject to the FERC cap on capacity release deals; correct?

A. I would.

Q. So the value of off-system sales can be determined by the cost differences between supply basins, can they not?

A. Yes.

Q. Do you still believe that the average value of capacity release in off-system sales can be no greater than .27760 cents a decatherm? I'm sorry, excuse me. It should be .27760 dollars a decatherm.

A. Capacity releases can be no greater than .2776 on Northwest pipeline.

Q. However, my question to you, sir, was --

MR. MEYER: Sorry, he's not finished.

THE WITNESS: I'm not finished with the answer. Off-system sales are a function of market value between basins in the amount of available capacity that exists between those basins. It can exceed the .277 number.

Q. So again, the average value of capacity release and off-system sales in the aggregate can exceed the FERC cap; correct?

A. It could exceed it or it could fall way short, depending on the market.

Q. Thank you. And I apologize for interrupting you before.

A. That's all right.

Q. I heard a pause. Referring to page 18 of your testimony, and it is, again, your rebuttal testimony, at lines 11 through 16, you suggest here that changing basin weightings impacts Avista Energy's decisions on how to hedge with fixed price gas; correct?

A. Yes, I do.

Q. Would you agree that the way the company's proposed mechanism is currently structured with fixed basin weightings allows Avista Energy to take gas from higher cost basins even if gas from lower cost basins is available?

A. Yes.

Q. And would you also agree that the mechanism that's currently proposed would allow Avista Energy to take almost no risk on its determination on where to purchase hedged gas because Avista Energy knows the composition of the first of the month ahead of time; is that correct?

A. I'm not sure I follow the question. Can you restate that?

Q. Surely. Would you agree that there is very low risk to Avista Energy in its decision as to where to purchase hedged gas when it knows the composition of the first of the month price prior to its purchase of that hedge?

A. Hedge gas is a part of Tier 1, is a -- is the basis -- well, it is the basis for Tier 1, and it is hedged at the basin weightings, and other than counter-party risk, the ability of a counter-party to pay its bills, credit issues, et cetera, there is -- those are the risks that Avista Energy experiences in doing the hedges.

I'm not sure I understand why there would be a risk to Avista Energy for hedging what's at the basin weightings.

Q. Are the risks that you just described the same risks that Avista Utilities would be exposed to were it purchasing hedges?

A. Yes.

Q. I'd like to refer you back to your direct testimony, page seven, table one.

JUDGE MACE: This is Exhibit 51.
MR. CROMWELL: Yes, Your Honor.
THE WITNESS: Page seven?
Q. The table one that we discussed earlier?
A. Oh.
JUDGE MACE: That's on page seven?
MR. CROMWELL: Yes.
THE WITNESS: Correct.
JUDGE MACE: Thank you.
Q. The entry for estimated loss of transportation benefits and off-system sales, can you tell me who performed that calculation?
A. It was performed under my direction by our resource accounting group.
Q. Within Avista Utilities?
A. Yes.
Q. And how was that determined?
A. It was determined by a calculation of the transportation -- or I'm sorry, the capacity release and off-system sales that Avista Energy had performed over the four-year period. I say the four-year period. I have to check the length of the period in that study. And it was -- it attempted to compare what the Utility would have done under the same circumstances, and that is the Utility, the dollars

were adjusted for the way the Utility did capacity releases. This was shown in a work paper.

It was an adjustment to the Utility typically doing capacity releases on a first of the month basis, that is a monthly, so we reprice the capacity releases at first of the month index on the differentials between basins. We had made an adjustment for the Utility not doing as many off-system sales. Basically, the off-system sales to end users were adjusted out and the net of that entire study worked out to about just a shade under $6 million for -- I guess it was a three-year period, and we averaged that at $2 million a year.

So it was basically a study to determine what the Utility would have done if Avista Energy had not been doing it during that same period, which included the 2001 -- or 2000-2001 period.

MR. CROMWELL: Thank you, Mr. Gruber. I have nothing further, Your Honor.

THE WITNESS: Okay.

JUDGE MACE: All right. We'll resume tomorrow at 9:30. Let's be off the record.

(Proceedings adjourned at 5:08 p.m.)