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 VI Pages 318-545

A hearing in the above-entitled matter was held at 9:42 a.m. on Tuesday, November 25, 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 back on the record in UG-021584. This is the Avista petition for extension of the natural gas benchmark mechanism. This is the second day of our evidentiary hearing. I believe that we left off last night, cross-examination by Staff and Public Counsel of Mr. Gruber have been completed, and we were going to turn next to the Commissioners for questions.

Whereupon,

ROBERT H. GRUBER,

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

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Yes, good morning. And I'm probably just going to be getting warmed up thinking about this case as I ask questions. I apologize.

A. That's all right. Good morning.

Q. But I thought one way to put this issue is to compare the hypothetical of if Avista Utilities takes back this function and is thinking about buying a financial hedge versus handling this on its own, and compare that to Avista Energy doing this function and thinking about a financial hedge compared to doing these services on its own, it would be an interesting comparison.

And when I mean that, let's assume that in these -- in this scenario, the Tier 1 decision has been made identically by Avista Utilities versus Avista Energy, and let's assume that the Tier 2 purchases are made identically, and I recognize there's some different judgments or ability in that, but I just want to take that off the equation, so we're dealing with Tier 3. Now, if you -- and I guess it would be you --

A. Yes, it would be.

Q. If you take this function on at Avista Utilities, first of all, would it be possible to go and get a financial hedge to insulate Avista Utility from any daily variation? Is that the kind of thing that you could go out and find?

A. In the process of working on this application, we looked at the cost of the -- covering the swing volume, if you would, which would be -- now would be Tier 3. In the current mechanism, the swing is covered by Avista Energy in Tier 2, but we looked at covering that daily swing by going to the market and asking for a -- we ask for what's a straddle, but essentially it is a put and a call. So you have the ability to call on gas if you need it from a supplier, you have the ability to put gas to the supplier or not take gas that they're selling you, or if you've purchased gas up to Tier 2, basically you can put that gas to a supplier or call on gas as your load swings.

The cost of that on an annual basis, we actually surveyed 14 or 15 suppliers with a request for proposal. We got one response that was responsive to our request, and the cost of that we calculated at about $1.4 million a year, as I recall, and so it is possible to do it. It is an expensive proposition, because you're having someone stand by to cover the load swings, which Avista Energy does for us now from their portfolio.

Q. Okay. So if you are in Avista Utilities trying to decide whether to buy such a hedge for $1.4 million, don't you compare it to your own ability to manage the basins and purchases --

A. Yes.

Q. -- and make those choices yourself?

A. Yes, we would make that comparison.

Q. Okay. Now, if this is done by Avista

Energy, I presume they could go out and buy the same type of financial hedge that you looked into?

A. Yes.

Q. And my first question would be wouldn't the price be almost the same because it's -- whoever is taking this on is taking on the same function, or would there be any difference, for credit reasons or I don't know what other reasons, in that $1.4 million price?

A. I think that there may certainly be differences because the counter-parties that Avista Energy deals with know that they're in the market all the time, every day, trading, and they have a fairly large portfolio to trade in and out of.

So to counter-parties, the apparent risk of Avista Energy being able to absorb or actually to want to put gas or take gas from them would be -- they may address the risk differently, so I think Avista Energy may have been able to get a different price for it, I don't know for sure, price it that way.

Q. In other words, the counter-party would be betting that Avista Energy would not call on it as often to provide the hedge because --

A. For whatever reason.

Q. Right.

A. It's possible, yes, that they may not.

Q. All right. Well, for the moment, let's assume it's the same price, 1.4 million.

A. Okay.

Q. Now, then, if Avista Energy is trying to also look at the tradeoff between should it or shouldn't it buy that financial hedge, it looks at its alternatives to buying that hedge?

A. Yes.

Q. And it's right -- well, let's say Avista Utilities puts a value on -- Utilities, Avista Utilities puts a value on its alternative to buying that hedge, and I'm just going to call it value X.

A. Okay.

Q. And now Avista Energy is doing the same thing. It's looking at its alternatives to avoid or -- its alternative to that $1.4 million hedge. And so it calls its alternative Y.

A. Okay.

Q. Now, isn't the delta between X and Y one way to measure the relative advantage, if there is one, of Avista Energy doing this job versus Avista Utilities doing the job? And I'm -- and how to put that value, X and Y, I'm actually not sure, but it seems to me that if Avista Utilities is looking at the $1.4 million hedge, they'd be saying, Well, gee, that's a lot of money. We can manage the basin, we can make purchases, we have some ability to move in the market.

Avista Energy would be doing the same kind of evaluation, but they might -- and that's my question to you -- do it differently. That is, they might say, Gee, we can be more aggressive in managing the basin. We have a lot more volume, so we can offset amounts at certain times, making it less likely that we would want to exercise that particular 1.4 million.

A. Mm-hmm.

Q. I'm trying to get at that difference, because it seems to me that tells you a little bit if Avista Utilities would be -- if the delta between that $1.4 million and Avista Utilities' in-house operation is less than the delta between $1.4 million and Avista Energy's operations that tells you there's a relative advantage, then maybe that advantage should be paid for, split, or something between the two utilities. I'm getting at this conceptually, and I'm wondering if you can help me. First, do you understand what I'm trying to get at?

A. I think I understand what you're trying to get at. I'm not sure how to calculate the value X or Y. I could say that certainly Avista Energy, because they are more active in the market and they are trading on a wholesale basis, they're trading every day, they would certainly have a greater ability to utilize or avoid utilization of such a mechanism.

The $1.4 million is a reservation charge, if you will, or demand charge that is paid whether you use the service or not. It is paid to have the service available. The gas that you purchase under the service, under the mechanism, would be at index. That is, at whatever the market is today.

So it isn't -- if I pay an entity $1.4 million and they stand ready to deliver gas to me or to take gas from me at the market, at the daily market on any day, and the 1.4 million is to -- is to compensate them for being able to have enough volume or liquidity to be able to take that gas or deliver gas to me on any day, Avista Energy does a lot of that now. I mean, they have a portfolio that is certainly much larger than the Utilities', and I think I yesterday misstated that it was three percent. It's eight percent of the physical gas. That is out of the Utilities' volume on an annual basis is about eight percent of Avista Energy's physical volume. They do a lot of financial transactions, as well, with three percent of the total, financial and physical transactions. But because they are so large, because they are in the market every day, trading, both buying and selling in the various basins, they have the ability to cover those swings for us.

Now, whether they would buy that service to cover our needs, they may be able to get a better deal, but then, again, I'm not sure how to calculate the difference between X and Y, but I suspect that their Y value in your example would be smaller than the Utilities' cost of doing it internally or the Utilities' ability to do it internally.

Q. Well, I guess another way to look at this would be more directly. Apparently you can get a hedge for $1.4 million, and instead of doing that, you're proposing this benchmark mechanism?

A. That's correct.

Q. And I'm a little unclear how to compare that $1.4 million if you exercised that hedge. If you took this job in-house and exercised that hedge for $1.4 million, that would be a cost to you?

A. Yes, it would.

Q. Now, you would have no opportunity, would you, to earn more or less, or would you? Would you still have your opportunity to manage the gas basins and make a profit?

A. You would have -- it depends on how the hedge was set up or the financial instrument was set up. You would have the ability to do some basin optimization. You may be restricted -- it depends -- if you're going to buy a put and a call, you have to do it at a point, so you would have to allocate it between basins. You would still have the ability to do some basin optimization. It may be limited a little bit because you would have to commit to the basins, but I think --

I guess where I am in comparing the value, what Avista, under the proposal, what Avista Utilities would pay Avista Energy is the management fee of 900,000 a year. They get that service, which Avista Energy then will deliver gas or take gas at market every day and provide that service among other things, in addition to providing basin optimization, in addition to providing storage management and some cost sharing around all of those pieces that -- the transportation optimization, the storage, and the commodity.

So in addition to being, you know, in simple terms, the 900,000 being less than 1.4 million, the Utility has an opportunity to share in the optimization of the other assets through the 80/20 sharing. So if Avista Energy makes more, we make four times as much.

Q. All right.

A. Or four-to-one.

Q. So to the question why isn't taking it in-house with a $1.4 million hedge a better deal than the proposed benchmark mechanism, you would say, first, the flat payment that you pay is $500,000 less?

A. That's correct.

Q. Okay. But after the $500,000, you are guaranteed $3 million and 80/20 splits after that, but the 80/20 splits, of course, could be lost?

A. Yes.

Q. Losses. So let's say you now have -- you're $3.5 million better off, but you're subject to 80/20 split, which could work in your favor, but could work to your disadvantage, compared to what if you had gotten 100 percent of profit, of additional profit --

A. That's true.

Q. -- without much offsetting loss. Is that about right?

A. That's -- yes, that's about right. I guess the other piece of that formula is that I believe I could probably match the -- or come close to matching the $3 million guarantee at the Utility. You know, historically, we had releases that would approximate that number. I mean, we could meet the $3 million, so I hadn't put that in the formula, but it's certainly an opportunity to gain above that three million on both sides of the equation we share, or it's an incentive for Avista Energy to do well because they share in part of that benefit and the customers gain by it.

And the capacity release, off-system sales portion of this is really the biggest benefit, I think, to customers. I mean, if you look at the table in my testimony, it's -- it is the largest number, certainly, of the individual components, and Avista Energy brings a lot to the table in terms of being able to offset the -- our transportation costs or recover dollars through capacity release and off-system sales. They're very active in the off-system sales market and provide the ability to sell to customers that the Utility would not normally sell to other end use customers outside our service territory in their marketing program.

Q. So Avista Utilities would be more conservative in its activities than Avista Energy, but in addition, you think Avista Energy would have an incentive to make a profit for you, but also would -- would have the expertise --

A. Yes.

Q. -- to go in that direction? You have to put some faith, don't you, in Avista Energy's abilities to respond to the incentive --

A. Absolutely.

Q. -- not just be subject to one?

A. Absolutely.

MR. MEYER: May I -- and I mean this to be helpful.

CHAIRWOMAN SHOWALTER: That's okay. If I've made a mistake in my question, go ahead.

MR. MEYER: I just want to make sure the record is clear, and it may simply reflect confusion on our -- this end of the table, but -- and I didn't want to get in the way of your conceptual argument of X minus Y, but I think the premise -- before we get too locked in on 1.4 million as the X, I just want to clarify with the Witness whether, in fact, that 1.4 million was truly with reference to Tier 3 or was it, in fact, with reference to a study done on Tier 2?

THE WITNESS: I'm sorry. I thought I made that clear. It is -- it was in reference to a study that was done to satisfy the load swings in Tier 2 under the current mechanism. It doesn't cover the load swings in Tier 3 in the current mechanism.

This gets confusing. I apologize for the complexity of it, but it is -- simply put, it -- the current mechanism has Tier 1, which is fixed in storage, fixed price in storage. Tier 2 is a broad band in which Avista Energy guarantess first of month index, and they cover load swings in that. It covers a broader band, a slightly broader band than the Tier 2 in the proposal.

The load swings over and above Tier 2 in the proposal, in what is currently before us, or what we're currently proposing, Avista Utilities would cover load swings -- or Avista Energy would cover load swings for Avista Utilities at gas daily.

In the current mechanism and the study for the 1.4, it was what would it take to replace the service that Avista Energy provides just to cover load swings in Tier 2. There are additional costs beyond that. I'm sorry. It's a good point.

Q. Okay. So I won't take the -- I didn't actually expect you to produce a real number.

A. Yeah.

Q. And so the 1.4 million I'll just consider to be an example of what a hedge might be. But you're telling me you don't really know if a hedge for just the Tier 3, under the circumstances we posited, would be more or less --

A. It would be --

Q. -- than 1.4 million?

A. To cover all of the Tier 3 clear to design peak day, I think it would be more, substantially more than -- because you would have a broader range, so it would be more than the 1.4 in my example. And thank you for taking it just as an example.

Q. Okay. Another question. I just am curious about currency and how it works. I don't need a lot of detail, but I don't really understand it. Is this an aspect of prices being locked in at a certain point of time, but if they're delivered later, Canadian currency has changed in the meantime? How does this currency advantage work or --

A. The contracts that we have -- the agreement we have with Avista Energy is to purchase gas out of AECO or Alberta at -- in U.S. dollars per decatherm or MMBtu. Most of the trades occur -- virtually all physical trades at or in Alberta occur at Canadian dollars, in Canadian dollars. So as that moves during the month day-to-day, week-to-week, it can have an impact on your cost.

Q. All right. So if you look at Bench Request Number 1, do you have that?

A. I do, thank you. I have it.

Q. I'm looking at the currency lines under both Avista Utilities and Avista Energy.

A. Correct.

Q. And does a positive mean that Avista Utilities benefited under the total? I'm looking under -- at a figure that ends 000. Oh, they all end 000. Well, before that is a --

A. On the currency line, in the middle part of the graph under Avista Utilities; is that where you're looking?

Q. Right. And I'm looking at a total that ends with 6,000.

A. Yes, that is a benefit under the mechanism to Avista Utilities.

Q. Okay. So Avista Utilities benefited and Avista Energy lost by identical amounts?

A. Correct.

Q. And is that because Avista Utilities agreed to buy in U.S. dollars and, over time, in the meantime, the value of the dollar apparently slid compared to Canadian dollars?

A. Yes, this was the number that ends in 6,000, as you see is the same for several months.

CHAIRWOMAN SHOWALTER: It's under the total.

JUDGE MACE: It's not confidential.

MR. MEYER: You're right. You can use the real numbers.

THE WITNESS: The $176,000 currency --

Q. See, we were talking about different -- I'm looking at the total. I was looking at the 616,000 under total.

A. Oh, I see, I see.

Q. Under the total column.

A. Okay, in the total column.

Q. Right.

A. Okay. That total column is -- the 616,000 is simply the sum of the years exposed here or the years reflected in this chart, and the 176,000 per year, if you go back to 2000, 2001, 2002, it's the same each year. It's different for the partial years in the ends.

It was a result of a study we did based on what the currency exchange rates had been and what our exposure was. And so this -- while this is our closest approximation of actual benefits and costs under the mechanism for the four years, it does have some estimates in it, and this is one where we've estimated a cost of -- or what the exposure is for the currency exchange rate.

Q. But does this reflect -- if you look -- does this reflect what Avista Utilities would have paid had it been doing the job instead of Avista Energy? It would have paid $616,000 more?

A. Yes.

Q. Okay. Because of the --

A. Yes.

Q. -- difference in currency?

A. Yes.

Q. Okay. All right. Can you turn to Exhibit 53, which is your rebuttal testimony, page seven, at the very top, so it begins at the bottom of page six.

A. Okay.

Q. And at the very end of page six, there's a sentence, It is not appropriate to normalize one side of the analysis while not normalizing the other side of the analysis. We believe, by normalizing both sides of the analysis, the benefits would remain at two million.

Is that just the double counting issue or is there something else about normalizing? I just want you to explain what you mean there.

A. It was the double counting issue in which the analysis of capacity release revenues that Avista Energy incurred or accomplished for the four-year period, Mr. Parvinen reduced that by making an adjustment for the anomaly period of November and December of 2000. And the Utility had made a similar estimate or we had provided an estimate of what the Utility would have, potentially could have accomplished during that same period.

And the point in this $2 million adjustment is that Mr. Parvinen reduced the Avista -- in comparing, he reduced the Avista Energy side of the equation for that two-month anomaly, but did not reduce the Utility side of the two-month anomaly. There was no other normalization in this in terms of weather normalization or anything like that.

Q. Okay. And I'm going to ask Mr. Parvinen about that, too, but I understand your point.

A. Sure.

CHAIRWOMAN SHOWALTER: Those were all my questions. Thank you.

THE WITNESS: Thank you.

JUDGE MACE: Commissioner Hemstad.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. I want to pursue the currency issue. In your table one on page three of Exhibit 53, your rebuttal testimony, the difference there between you and Staff of the $176,000 figure that has been referenced as zero, well, the $176,000 reference is -- reflects the historical events; isn't that right?

A. The 176,000 is a result of a study that we did and provided to Staff about a year ago, actually, in this case. It was our analysis of the exposure, the potential annual exposure.

Q. Well --

A. It isn't -- I couldn't say that it is what we actually experienced in any 12-month period. It was over a period of time with some assumptions.

Q. But attempting to project that forward into the future, why wouldn't it be zero, as Mr. Parvinen has concluded in his testimony, in that it is speculative as to whether you would be benefited or disadvantaged in the movement of currencies?

A. It could be zero. It could be zero.

Q. Well, it could be, but you don't know?

A. We don't -- that's just it. We don't know.
Q. But can you conclude that there would be either an advantage or a disadvantage? How do you make that kind of conclusion looking forward on currency movements?
A. It's looking -- looking forward by looking back, basically. What we've seen in the past, through this study, we determined that it's our estimate there could be that much exposure to currency. It could be less, it could be more.
Q. But if you see that as an exposure that you're confident, reasonably confident would be there, then you could hedge against it?
A. Yes, you can.
Q. And bring it to zero?
A. Well, yes, there's a cost to hedge against it, but you can mitigate that.
Q. I'd asked Mr. Norwood about the graphs in Exhibit 22. That's the 1997 natural gas integrated resource plan, at pages C8 and C9.
A. Okay.
Q. And I'm curious what that would look -- what those graphs would look like brought forward to the present. Is there anything in the record that describes that?

A. Well, we have -- we went back and took a look at what the capacity release and off-system sales revenues were, and I could tell you that, for 2002, calendar 2002, the capacity releases -- capacity release revenue was $3.3 million, and the off-system sales were $1.6 million, for a total of 4.9. And in 2003 to date through September, capacity releases of $3.9 million and off-system sales of about $200,000, or .2 million, for a total of .41 million.

So we see capacity releases and off-system sales go up and down over time, and it's a function of the market, but as a -- just as a check against where we are, it's 4.9 million in 2002, and 4.1 so far in 2003.

Q. And for the middle years between the graphs and those that you just referenced?

A. There were -- I don't have those numbers in front of me. We can get those numbers. There are --

MR. MEYER: May we interrupt, and we can get those to the Witness?

THE WITNESS: We had substantial swings in the market, of course, because of the energy crisis and constraints on the Northwest Pipeline System. 1997 total, 5.7 million. That's 3.3 million capacity release, 2.4 million off-system. 1998, 8.4 million total. That's capacity release, 4.7 million, and off-system sales 3.7 million. 1999, which was partially managed by the Utility, partially by Avista Energy, 5.6 million. Four million of that was capacity release, 1.6 million off-system sales. For 2000, which was the -- has the biggest impact, 13.2 million, 3.7 million of that was capacity release, 9.5 off-system sales. And 2001 is 6.2 million, of which 3.7 million is capacity release and 2.5 million off-system sales.

So the -- it's been in the five to six million dollar range, with the exception of 2002, actually four to five million. We had some swings up in '98, when there were substantial constraints on Northwest Pipelines System, and there were, of course, the impacts of the energy crisis in 2000.

CHAIRWOMAN SHOWALTER: Is it possible to get whatever exhibit or whatever piece of paper you just provided? Otherwise, we'd have to find it in the transcript.

MR. MEYER: Sure.

JUDGE MACE: Let's make that Bench Request Number 2.

COMMISSIONER HEMSTAD: Make that a bench

request.

MR. MEYER: We'll just -- we'll get it out, print it out in a legible form.

COMMISSIONER HEMSTAD: Or in graph form, however --

MR. MEYER: Whatever.

COMMISSIONER HEMSTAD: Bench Request Number 2?

THE WITNESS: Because I've just got a handwritten sheet. We did some study last night.

COMMISSIONER HEMSTAD: That's all I have.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Oh, then, can I just do a follow-up to Commissioner Hemstad's question on the -- relating to the currency? And that was on page three of Exhibit 53.

A. Okay.

Q. Wouldn't the value of avoiding risk of currency be more than zero, but less than 176,000? In other words, isn't the figure that should go in here is what it would cost to go and get a hedge for bringing the risk to Avista Utilities down to zero?

A. The only reason I hesitate -- yes, it is --

that's correct. The only reason I hesitate is I'm not sure -- I'd have to go back and look at our study if that's the cost of the hedge or if that's the exposure. I believe that's the exposure, so the hedge would most likely be less.

Q. I have no idea what hedges cost in such situations. Is it 4,000, 50,000?

A. I have -- that might be a better question -- I hate to defer, but that might be a better question for Mr. D'Arienzo, but I am not -- I'm not sure what a hedge would cost on that.

Q. All right. Thanks.

A. I would hesitate to guess. It would be a guess.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. Well, pursuing the point, I referenced a hedge only in the sense that if you were confident that you were going to lose or you were going to win, you know, we'd all be rich, and you would act accordingly. And I suppose the cost of a hedge is a translation of the risk?

A. Yes.

Q. But I take it, in these kinds of

transactions, you're not hedging on the currency issue?

A. Well, if we felt strongly that it was going to move one way or the other, we would take a look at doing hedges. I mean, we would analyze it through a strategic group similar to what we do now for the hedges of the physical supply.

What we were trying to represent here is what the customers are potentially exposed to in currency risk if it was brought back to the Utility, and yes, we may be able to mitigate that, some of that currency risk with a hedge.

COMMISSIONER HEMSTAD: Thank you.

JUDGE MACE: Commissioner Oshie.

E X A M I N A T I O N

BY COMMISSIONER OSHIE:

Q. Mr. Gruber, I'm going to follow-up on some questions that Mr. Norwood deferred to you yesterday. I'm sure you've had -- if you were here, and I know you were, you've had some time to think about them, but that's fine.

I'm interested in pursuing the makeup or the nature and decision-making authority of the Strategic Oversight Group.

A. Okay.
Q. Of which you are a member, as I understand, along with Pat Gorton, the risk manager. I think that's the title.
A. Yes.
Q. And is it Ms. Gorton; is that right?
A. Yes.
Q. And she works for Avista Utilities?
A. Yes, she does.
Q. And then the third member of the Oversight Group is Mr. D'Arienzo, who's here?
A. Yes.
Q. Okay. And as I understood from Mr. Norwood, is that I guess there was some lack of clarity as to the decision-making within the group, and perhaps you can clear that up as to how decisions are made within the Strategic Oversight Group?
A. Certainly. Thank you. The Strategic Oversight Group was put together to oversee the hedging program. We look at a number of different things beyond that, but we meet periodically, as necessary, to review a number of different things and to make recommendations or to come to a consensus about how the hedges should be executed or set targets, essentially is what we do, set targets for

the hedges.

We look at -- we sit down and we -- Mr. D'Arienzo brings a considerable amount of expertise to the table about what's happening in the market, what we think forward prices are going to be in the market, what our exposure is if we wait to do a hedge.

But the structure that we have under the existing mechanism and the guideline that we propose in the proposed mechanism is to layer in a series of hedges for roughly half of the load, half of our average load over the course of the year, and that happens in a series of windows, some of which are fairly structured. It's a very disciplined approach to a hedging program. Part of the hedges are structured in a time frame. In other words, we have windows in which we would exercise hedges for next winter. We have some of the hedges -- about half of them are discretionary. We can decide to hedge those in February or March or November, depending on what we think the market is going to do.

The Strategic Oversight Group gets together and discusses where the market is, what the weather forecasts are, long-term, short-term, a number of different things. What the hurricane season is going to do to the gas market, it has a big impact, what the world oil market is doing.

So we look at all of those things and set for each period a target of this is where we want to -- say if we're buying hedge, looks like we've got hedges to exercise for the November-March time frame, for example. We set a target for Avista Energy to exercise those hedges and a window within which to do that.

Q. What's your role within the Strategic Oversight Group?

A. I guess you could say I chair the Strategic Oversight Group.

Q. And the decisions, you said, are made on a consensus basis or, in other words, if you can't agree, what happens?

A. We -- they're made on a consensus basis. We all bring different views and different experience and exposure to the table in terms of satisfying the Utilities' needs, what the market is, and while we don't always agree that -- we don't always come to the table with the same thought, we end up working it out to this is the best thing to do now, given all of those various parameters, and we come to a consensus opinion.

Q. What's Ms. Gorton's role on the SOG? That's easier to say.

A. Ms. Gorton's role -- or Gorton's role on the Strategic Oversight Group is she represents the Utilities' risk -- she's a manager of risk at the Utility, and she represents the -- or reports back to the Risk Management Committee at the Utility Executive Committee at the Utility and brings the expertise of not only the -- well, all of her expertise in risk management, and she used to be in gas acquisitions, as well.

I would add to that, if I might, we report -- when I say we, the results of the Risk Management -- or I'm sorry, the Strategic Oversight Group are presented and have been presented a number of times to our senior management through their Risk Management Committee, which is comprised of our chairman, general counsel, chief financial officer, president of the Utility. It's also presented to the Senior Officer Group through our -- what they call operations council.

For example, recently it was a question of if the market is continuing down, should we hedge more, and we went through that analysis and took that back to the officers and made some recommendations

about what we should do.
Q. Are the officers then the decision-makers or --
A. Ultimately, yes.
Q. Has there ever been a decision or a recommendation of the SOG that has been overturned, if you will, by the officers of the corporation?
A. No.
Q. Is the Strategic Oversight Group, is that where the deal, if you will, between Utilities and Energy is struck, negotiated?
A. It isn't really a negotiated deal between the Utility and Energy. It's more of a consensus that this is the target for hedges that we want to accomplish in this period. It isn't a negotiation of what price are you going to give us.
Q. Well, who decided, for example, that the management fee should be $900,000? Does that come out of the SOG?
A. Actually, it came out of the team that put together this application. It wasn't an SOG discussion that specifically found $900,000.
Q. Do you know who within Utilities would have agreed to the $900,000 management fee and what person within Avista Utilities would have said that's

reasonable, let's do it, or let's recommend it to --

A. I think the recommendation to change from what was originally a volumetric fee of a nickel per decatherm to the $900,000, which is roughly comparable, was presented to a number -- well, the senior management of the company, and they agreed that it was a reasonable approach.

Q. Senior management of Utilities?

A. Yes.

Q. And I would assume that it would -- there's -- a similar path would be taken within Energy?

A. I would assume so, yes.

Q. As far as the operation of the SOG, as I understand it, a consensus decision would be made and the recommendations then would be forthcoming to upper management within the corporation for the gas that is purchased, the resource purchased for Tier 1, including the storage component, and I guess -- so that would mean -- let's -- and then for Tier 2, the same would be true, as I understand it. A decision would be made by the group and an implementation would be -- would be carried out by Energy.

And for Tier 3, there would be a decision made by the SOG to either purchase or sell gas, depending on where the Utility is in its -- when it looks at its balance, if you will, for the day.

And I guess I have a question as to does -- and I think Mr. Norwood answered this, but I want to make sure it's clear -- is that if the decision on any day, let's say, is out of balance and short, so the decision for the Utility, then, is to get in balance, you either pull from storage or you go out on the market. And would that be a decision made by the SOG?

Let me put it this way, Mr. Gruber. How are you involved in that decision on a daily basis?

A. If I could clarify a couple of points there, and I will certainly respond to that. I guess maybe I'll start with a response to that, and that is, on a daily basis, the decision to cover Tier 3 with storage versus buying in the day market, I would be directly involved with that decision every day. When that decision is made to purchase the gas for the following day, I would be on the phone with Avista Energy and we would go through the analysis of is it more economical based on today's price versus forward price to pull storage or should we buy gas today.

Just a clarification in the Tiers 1, 2 and 3. Yes, the Strategic Oversight Group establishes the targets for exercise of hedges in Tier 1. We, together with the -- with Avista Energy, I get involved in the economic decision of whether to inject storage outside of the synthetic schedule on an economic basin, which there may be some sharing for Tier 1.

Tier 2 is purchased at our average load at first of the month index. There's not a -- there's not a big interaction between the Strategic Oversight Group or myself and Avista Energy on those physical purchases for Tier 2, but Tier 3 is -- we interact on Tier 3 or would interact on Tier 3.

Q. Has there ever been an occasion in the -- I guess in the decision-making of the SOG wherein you have not followed the recommendation of Mr. D'Arienzo?

A. I think there have been times when we may have reached a conclusion that was different than Mr. D'Arienzo's initial read of the situation based on what we thought utility loads were going to do or what we thought the market or the weather was going to do, but I don't know that we've ever had a disagreement about or had to overrule any particular member of the group in terms of how we do things.

I mean, it's a -- we work well together and we -- the idea behind the Strategic Oversight Group is to look at all of these various components, market, et cetera, and provide the best decision given the situation and the time frame, and that is the best decision on behalf of customers.

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

JUDGE MACE: Mr. Meyer.

MR. MEYER: Yes.

JUDGE MACE: Redirect.

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. Let's stay with the subject of the SOG. How would you characterize these SOG meetings in terms of the scope and extent of discussions?

A. It can be fairly broad ranging, that the scope generally is targeted at the hedging program. We also get into a -- we get into discussions about, you know, how we should manage storage on a seasonal basis, if it should be outside of the synthetic schedule or targeted schedule, how purchases are made.

Q. Would you characterize these discussions as involving a good deal of give and take?

A. There's a lot -- yes, there's a lot of interaction between the --

Q. As part of that interaction, can you think of instances where initial positions or recommendations or discussion points were modified or adjusted as a result of those discussions?

A. Yes.

Q. Does that happen almost never, sometimes?

A. Sometimes. I would -- I don't know if it would be half the time, but it would certainly be a fair amount of the time.

Q. So in your view, do you think the SOG process is worthwhile?

A. Absolutely.

Q. In terms of the reporting and discussion upstream, if you will, from the SOG group to upper management, how would you characterize the detail and scope of those discussions that you, as a representative of the SOG group, have with senior management in terms of strategies and involving hedges, for instance?

A. Well, my interaction with the -- with senior management on the hedging program, for example, is to take to senior management the Strategic Oversight Group's recommendations and lay out why we're -- why we're recommending what we are in terms of hedges, hedging more, hedging less, exercising time frames.

Q. Does that engender a fair amount of discussion, then?

A. Yes, it does.

Q. Are you questioned?

A. Yes.

Q. And do you do that on several occasions?

A. Yes.

MR. MEYER: Okay. If you wouldn't mind, if you'd accept a handwritten version of your response to Bench Request Number 2, would that be acceptable?

JUDGE MACE: I don't think there'd be a problem with that as long as we can read it.

MR. MEYER: I think you can, and we'd just as soon get it in front of you, if that would be helpful.

JUDGE MACE: Why don't you show us what you have.

MR. MEYER: I'm sorry?

JUDGE MACE: Show us what you have.

MR. MEYER: This is what I have in mind.

JUDGE MACE: Okay. Pass it out and let us take a closer look at it.

MR. MEYER: Sure. You need two for you.

JUDGE MACE: Yes, please, and would you make sure Mr. Garcia gets a copy, as well?

CHAIRWOMAN SHOWALTER: Which bench request is this?

JUDGE MACE: This is Bench Request Number 2, and handwritten.

CHAIRWOMAN SHOWALTER: That's okay.

JUDGE MACE: I don't think the reporter -- you can have one if you want one, but usually the reporter doesn't --

MR. MEYER: Friends, relatives, Christmas gifts.

JUDGE MACE: I don't want to speak for you, but --

MR. MEYER: Hopefully you can read that, but I think those are consistent -- well, let me ask the witness.

Q. Are those consistent with the numbers that you read earlier into the record?

A. Yes, they are.

Q. Very good.

A. I may have left off 1996, because it was in the IRP.

Q. Okay. Well, hopefully that helps. And just a follow-on to that, you talked about the more recent years of '02, and at least the first nine months of '03, and what -- as you look at the trending up or down over time, what broader market factors have influenced in the region the ability to release capacity or make off-system sales? What explains these variations through time?

A. Like most market issues, it's a supply and demand issue. The availability of capacity on the system has a large impact on the dollars that are recovered through capacity release and off-system sales. When there are constraints on the system, when there are high demands on the system because of a large price differential between basins has occurred in 2000, it has a big impact on how much you can recover on off-system sales and capacity releases, for that matter.

When the pipelines build capacity, those constraints are, at best, eliminated; at a minimum, they are relieved, generally, and so more capacity is available. A number of capacity expansions on Northwest Pipeline and Gas Transmission Northwest have occurred over the last three years that were -- some were designed for serving power plants. Those power plants, some were built, some have been suspended, some are not going to be built.

So there is -- I won't say a glut, but there is certainly an excess of capacity available in some corridors on the system, and that has a downward impact on what you can recover in transportation through off-system sales and capacity releases.

Q. Have you, in the past, been personally involved with the capacity release program and off-system sale program at Avista Utilities?

A. Yes, I have.

Q. In fact, you were principally charged with that responsibility; isn't that correct?

A. My primary function was capacity release manager, if you will, for '97, '98, '99.

Q. Mm-hmm. Now, as -- you just, in the prior response, you talked about market dynamics, market changes. If you were to prognosticate, if you will, if you were to look ahead for the next few years, what levels of capacity release and off-system margins do you think are sustainable over the next few years with effort expended?

A. With -- sorry, with effort extended, I think you are probably in the -- for this chart, for Washington only, in the 4 to $5 million range. A number of things impact that. One is what I just talked about in terms of available capacity on

Northwest Pipeline.

Others are changes in requirements of industry. Most of the aluminum load is gone, for example, so we have lower releases and off-system sales to the aluminum industry, we have some generation contracts that are contracts for capacity releases for thermal generation that will be restructured within the next year and may go down. It's not -- I can't say we could guarantee that you would be at the $6 million range. It's probably in the four to five.

Q. Would Avista Energy, as your agent, have to work to get to the 4 to $5 million level of releases in off-system revenues?

A. Absolutely.

Q. You were asked -- let me just reverse field here and go back in my notes from yesterday afternoon. I believe it was during the discussion with Public Counsel over the -- remember the discussion around 69 cents rate or assumed rate that Public Counsel used in its testimony?

A. Yes.

Q. And that had to do with rates for what? It was a 69-cent per decatherm rate for what?

A. It was for recovery of transportation assets through capacity release and off-system sales.

Q. Okay. And do you remember the exchange, the questions and answers regarding the maximum capped rate for capacity releases?

A. Yes, the capacity releases are under FERC regulation and are capped at the maximum -- maximum tariff rate, if you will, for each of the pipelines. Northwest Pipeline is a little over 27 cents. The capacity -- or the off-system sales are not under such regulation. We had a lot of discussion about that.

I will say that we -- the off-system sales, while they're not capped by the FERC regulation, they are certainly a market issue. That is, they are controlled by the market. And just as a, for the lack of a better term, a reality check, if you will, we looked at numbers last night and recalculated the three years ending August of '02. Our combined recovery on a per decatherm basis for both capacity releases and off-system sales was 22.7 cents. In that number, approximately 13.4 cents is for capacity releases.

Q. And what was the other component for the off-system sales?

A. The off-system sales were 36.1 cents. And that included the 2000 time frame, where off-system sales were nine and a half million dollars on the chart in Bench Request Two.

Q. But you said the combined rate was what, twenty-two point --

A. Twenty-two point seven cents over a three-year period.

Q. And in terms of comparing apples to apples, how would you -- would you then compare and contrast that with the 69-cent rate used by Public Counsel Witness Elder?

A. Well, it's -- obviously, it's about a third of what was estimated in Witness Elder's chart. It would result in, rather than 10 million, something closer to three and a half or four million.

MR. MEYER: Excuse me.

CHAIRWOMAN SHOWALTER: I was just -- what were the three years that you covered?

THE WITNESS: The three years, it was three years ended August of '02. It was from September of 1999 through August of '02.

Q. Let's assume that, in fact, that for the moment that Ms. Elder was correct and that the combined rate was three times as high as actual experience and that it was at 69 cents. What impacts, if any, would such a rate have on decisions to build more pipeline capacity?

A. If you had a sustained value of 69 cents in the marketplace for a period of years, the pipelines would be building capacity, lots of it, because the market would demand it.

Q. And what impact would that have on the price spreads between basins, that additional capacity?

A. The additional capacity would typically have a dampening effect on the price spreads, flatten the value between basins.

JUDGE MACE: Mr. Meyer, how much more do you have in terms of redirect?

MR. MEYER: Oh, maybe five minutes. Just continue on?

JUDGE MACE: Go ahead.

MR. MEYER: Okay.

Q. So would you expect a rate that high, even if we were to assume a 69-cent rate, to sustain itself given the market reaction to that?

A. No, I would not.

MR. MEYER: Surprised myself. I don't have any more.

JUDGE MACE: We'll take 15 minutes.

(Recess taken.)

JUDGE MACE: Let's be back on the record. Mr. Trotter, do you have any re-cross?

MR. TROTTER: I just have a couple questions on Bench Request 2.

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

BY MR. TROTTER:

Q. If you could refer to that, Mr. Gruber. Am I correct that this exhibit does not reflect any revenue from basin optimization transactions?

A. That's correct.

Q. And under the existing mechanism for off-system sales and capacity releases, there is sharing only after five million in total capacity release and off-system sales has been realized; is that right?

A. That's correct.

Q. That five million is not guaranteed, is it?

A. That's correct.

Q. And under the existing mechanism, any benefit from basin optimization transactions go 100 percent to Avista Energy; is that correct?

A. Yes, and that revenue is -- covers the cost of the swing volumes in Tier 2.

Q. And so Avista Energy has an economic

incentive under the existing mechanism to do a basin optimization transaction before it would do a capacity release or off-system sales transaction if it had a choice of the three; is that correct? Because it would share 100 percent of that benefit to itself. There would be no sharing, and it would only share with customers if it was a capacity release or off-system sale -- it would have to share 100 percent with a customer until five million was realized; isn't that correct?

A. The capacity release and off-system sales are based on available capacity, as is basin optimization. The basin optimization that Avista Energy does, and I can let Mr. D'Arienzo explain probably further, but is related to the available capacity on a forward basis by buying and selling supplies or buying the basis differential, if you will, between basins forward.

Then they also look at what is available to move to the system from those basins. Any revenue that comes from using capacity to sell to others comes back through the off-system sales function.

Q. Well, I don't know if I understood that answer, but let me just move on. The existing mechanism was in effect in 2002, was it not?

A. From April of 2002.
Q. And Avista Energy realized over $4 million in basin optimization benefits in 2002, did it not?
A. Yes. Did you say in basin optimization or capacity release, off-system sale?
Q. Basin optimization.
A. Oh.
Q. You may want to look at Bench Request 1 in the 2002 column, the first two lines, and total those figures. Would you agree with me that the total exceeds four million by just a slight amount?
A. Hold on. Why don't I catch Bench Request 1.
CHAIRWOMAN SHOWALTER: While we're pausing, Mr. Trotter, can you please speak more slowly?
MR. TROTTER: I will. Sorry.
THE WITNESS: I have Bench Request 1.
JUDGE MACE: And can you repeat your question, please?
Q. The question was isn't it true that Avista Energy realized actual basin optimization benefits in 2002 of slightly over $4 million?
A. Yes.
MR. TROTTER: I have nothing further. Thank you.
JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: I have nothing, Your Honor.

JUDGE MACE: I'm going to admit Bench Request Number 2 at this time. Thank you, Mr. Gruber. You're excused.

THE WITNESS: Thank you.

MR. MEYER: I'd next call to the stand Mr. D'Arienzo. While he is situating himself and before I forget, can we, on the record, if we haven't done so already, stipulate to the admission -- I suppose we already have, as part of the settlement process -- the testimony and exhibits of Mr. Hirschkorn?

JUDGE MACE: All of the testimony and exhibits were stipulated into evidence during the settlement hearing.

MR. MEYER: So I guess the only thing here today is just recognizing on the record that parties have agreed that Mr. Hirschkorn need not appear.

JUDGE MACE: Right, and I understand the Commissioners are on board with that, so that's our understanding. That's how we're going to operate today.

MR. MEYER: Very well. I just didn't want to forget.

Whereupon,

MICHAEL E. D'ARIENZO,

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.

THE WITNESS: Give me just two seconds.

MR. MEYER: Sure. All set?

THE WITNESS: Thanks.

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.

A. Michael E. D'Arienzo.

Q. And by whom are you employed?

A. Avista Energy.

Q. And what is your position?

A. I'm the vice president of trading and marketing.

Q. And have you prepared prefiled exhibits, including testimony, that have been identified and admitted as Exhibits 101-T, 102-T, 103-C, 104 and 105?

A. Yes.

MR. MEYER: With that, I make the Witness 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. D'Arienzo, would you please refer to your rebuttal testimony, Exhibit 102-T, page three?

A. What was that again, please?

Q. 102-T, page three.

A. Okay.

Q. Lines -- starting on line 13.

A. I'm there.

Q. And you indicate that, with respect to the auditability of capacity release, both parties, and I believe you're referring to Public Counsel and Staff, have indicated that there is not enough detail to complete their analysis of transportation revenues. Do you see that?

A. Yes, I do.

Q. And you disagree with that; is that correct?

A. That is correct.

Q. And you point us to your Exhibit 104 in that regard; correct?

A. That's correct.

Q. Would you turn to that exhibit, please? We're on Exhibit 104, and I'd refer you first to page

three of that exhibit. Am I correct that pages three through nine of this exhibit contain the data that you state in your testimony permits a complete analysis of transportation revenues?
A. Yes, it does.
Q. I want to start with page three, and try to understand what this exhibit shows. And there's a shaded box at the top of the exhibit, and in the upper left-hand corner, it describes this page as use of Washington/Idaho transportation on PGT delivery points and volumes. Do you see that?
A. Yes, I do.
Q. So this refers to the company's transactions for the month of June 2003 on the PGT transmission line?
A. Yeah, to the best of my knowledge, yes.
Q. And then the shaded box in the lower left of the exhibit on this page three, we see that that box reflects the total PGT delivered volumes and values. Do you see that?
A. Yes, I do.
Q. And also in that box, it refers to the AECO hub, A-E-C-O; correct?
A. That is correct.
Q. So staying with that lower box, would it be

true that the total value of the transactions at just AECO for the month of June 2003 was the $910,286 figure shown in the box?

A. I believe so, but I would like to make one comment, and -- this is a report that is prepared by Avista Utilities' accounting department, and it pulls in data, and it's not a report that I generate and I'm not real familiar with as far as the actual putting together of it.

Q. But this is the report that you referred in your testimony and you're relying on for purposes of your testimony?

A. That is correct.

Q. Looking at the upper box, shaded box again, just a little to the right of center, there's a column that's entitled total AECO/Stan, for Stanfield, delivered volumes, do you see that?

A. I do.

Q. And there are three sets of figures in that column near the bottom of that column followed by a total; correct?

A. That is correct.

Q. Do these entries indicate that the total of the transactions that were done on each of those three days of the month of June 2003?

A. I believe what that shows is that gas was delivered to the Lancaster tap on the 27th of thirty-six-fifty, that gas was delivered to the Lancaster tap, a different tap, twenty-five-ninety-one, of 23,350, and then that was the total.

Q. Okay. And then, on the 29th, similar -- two similar transactions took place, and then on the 30th, just a single transaction took place; is that right?

A. Correct.

Q. And those are totaled up in the total line of that column?

A. I believe so.

COMMISSIONER HEMSTAD: Mr. Trotter, I think it's the 28th, isn't it?

THE WITNESS: Oh, on -- yeah, the 96.

Q. Thank you. I accept the correction. Now, so in that total AECO/Stanfield delivered volumes column, the figures there are the sum of the transactions that are detailed on the left side of the box; correct?

A. Yes.

Q. So there would be five transactions?

A. Yes.

Q. Okay. And were those all sales transactions?

A. Those would have been -- what this shows is that gas flowed on those agreements on those days, and they would have been sales.

Q. Okay. And nowhere on this page do you show the actual revenue Avista Energy received from the buyer in any of those transactions; it just calculates the value of the capacity; is that correct?

A. That is correct.

Q. Now, you report similar data on pages four through nine of this exhibit; correct?

A. That is correct.

Q. And the actual cost of the gas being sold off-system is not shown on those pages either, is it?

A. That is correct.

Q. Turn to page five of the Exhibit 104. And this shows an analysis similar to page three, except this applies to Avista Energy's transaction on the Northwest Pipeline; correct? We can see that in the description in the upper box?

A. That is correct.

Q. But the format is the same and the information is the same as with AECO on page three;

correct?

A. That is correct.

Q. I'd like to now turn to Exhibit 118. And this was the company's response to Staff Data Request 66. And this asked Avista to provide the volumes delivered to Avista Utilities' natural gas regulator operations in Washington by basin; is that right?

A. That is correct.

Q. Turn to the second page of the exhibit. And if we look down to the 2002 total line, this would show -- this line shows the actual volumes delivered to the Utility's Washington regulated operations in that year for those three basins; correct?

A. That is correct.

Q. Now, Rockies -- the Rockies basin is the last column, and you show a total of 5,903,354 decatherms from the Rockies; correct?

A. That is correct.

Q. And would you accept that the Rockies, compared to the other two basins for that year, comprised 33.2 percent of the total? Will you accept that subject to check?

A. I accept that subject to check.

Q. And during the 2002 period, the basin weighting that was assigned to the Rockies under the mechanism in effect at the time was 18 percent; correct?

A. I believe so.

Q. So this exhibit shows, in part, that 33 percent of Avista Utilities' total load was out of the Rockies, even though the weighting was assigned only 18 percent; is that correct?

A. That is correct.

Q. Now, with respect to the basin differential, in this instance, the basin differential would be the -- would be based on the difference between 33.2 percent and 18 percent; correct?

A. I'm sorry, I was writing a note here. Would you ask me that question again?

Q. How would you calculate the basin differential benefit to Avista Energy based on that 33.2 percent use of the Rockies versus 18 percent imputed weighting under the mechanism?

A. The way I would look at that, if I was able to bring in -- under basin optimization, if Avista Energy were able to bring in more supply at a lower cost, depending on what the variable was on the different basins, then I would capture that value.

Q. And it would be captured at the difference between the 18 percent and the 33.2 percent. That would be the value of the basin optimization; correct?

A. That is correct.

Q. And who captured that value? Did Avista Utilities capture that value or did Avista Energy capture that value?

A. Under the current mechanism that was in place during that period, that value would go to Avista Energy as a offset to the risk that we take in the Tier 2 for the low volatility.

Q. And are you aware of any document that supported the existing mechanism when it was filed that described the working of the basin optimization benefit that way that you just stated?

A. What I understand, when we took on the current mechanism, was that there would be certain assets of the Utility that we would be responsible for managing, and that, by taking that on, there were certain risks that we would take. And for that, we would have the use of the assets as long as we kept reliability and met the other criteria of the benchmark, which I believe we did.

Q. My question was whether you were aware of any document, and I'll be specific, filed with this Commission in the context of the current mechanism that explained the optimization benefit aspect the way you have just described it or similar to the way you've just described it?

A. I don't believe that there was a document that specifically stated basin optimization at that time.

Q. And basin optimization benefits were not highlighted in the tariff that you filed to start this case; it only appeared in your direct case; is that correct?

A. I believe so, and I think the reason for it was we probably didn't realize it was there, nor did we realize the volatility was there.

Q. Would it be fair to say that -- well, let me start over. Well, you knew the volatility was there since the year 2000, didn't you?

A. In 2000, I learned about it, yes.

Q. Now, sticking with this 33 percent versus 18 percent of the Rockies, would it be fair to say, since Avista Energy is using all the capacity it has from the Rockies to serve Avista Utilities' customer loads, the off-system sales value of that capacity is not being captured?

A. On that specific transportation component that I'd be using for the Rockies, that is correct.

Q. When Avista Energy lost $8 million from the mechanism in the year 2000, did Avista Energy attempt to rescind the agreement?
A. No, we did not.
Q. And did you hear -- I believe it was Mr. Gruber -- indicate that amendments to the agreement to address that particular problem did not occur until April of 2002? Did you hear him discuss that?
A. I heard the discussion.
Q. And is your understanding consistent with his?
A. Well, the discussion I remember was kind of vague, and so I think that, with the $8 million loss, that Avista Energy did not approach the Utility to change the mechanism because of that.
Q. Okay. Have you ever had any utility other than Avista Utilities -- let me rephrase it.
To your knowledge, has Avista Energy been approached by any utility, other than Avista Utilities, to have Avista Energy do their gas procurement function?
A. I'd tell you Avista Energy has responded to a couple of RFPs and they weren't -- one wasn't as specific as the one with Avista Utilities, so Intermountain Gas, we responded to an RFP, and it

didn't have all the same details. The other is we currently are the agent for the City of Ellensburg, and we responded to an RFP there.

Q. And you were the successful bidder for Ellensburg?

A. Yes, we were.

CHAIRWOMAN SHOWALTER: May I just interject? Is Ellensburg, is that a gas utility?

THE WITNESS: Yeah, it's gas and electric. It's the City of Ellensburg, so it's --

CHAIRWOMAN SHOWALTER: For gas consumption, not gas that goes into an electricity?

THE WITNESS: No, it's for their core customers. Many LDC, I guess.

Q. They do operate a gas distribution operation, is that your understanding?

A. That's correct. That's my understanding.

Q. Is Intermountain Gas a local distribution company?

A. Yes, that's my understanding.

Q. Where do they do business?

A. In the state of Idaho exclusively.

Q. And have you solicited any investor-owned utility in this state, other than Avista, to do the gas procurement function for them?

A. There have been no other RFPs by investor-owned utilities.

Q. I wasn't asking whether you responded to an RFP, but whether you solicited them?

A. I'm just thinking of customers and historically who we've talked to and if they would apply to that category. I do not believe so.

MR. TROTTER: That's all I have, Mr. D'Arienzo. Thank you.

JUDGE MACE: 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. D'Arienzo.

A. Good morning.

Q. My name's Robert Cromwell. I'm with the Public Counsel section of the Attorney General's Office. I have a few questions for you this morning, although fewer than I had anticipated asking, due to Mr. Trotter's efforts.

Would you please turn to Exhibit 102, which is, I believe, your rebuttal testimony. And turn to page five, if you would, please.

A. I'm there, thank you.

Q. And there you make an assertion that Avista Energy provides value to Avista Utilities because Avista Energy offers Avista Utilities the opportunity to -- I think, if I get the quote right here, transact in the marketplace in a manner which would not occur within the Utility; is that correct?

A. What line is that on, if you --

Q. I'm sorry. If you look down at lines 15 to 17?

A. Okay. Okay. I've read it. Thank you.

Q. Did I quote you correctly?

A. That is correct.

Q. Would you agree with me that Avista Energy should only be rewarded for its ability to extract value from the portfolio that it manages for Avista Utilities which could not be extracted by Avista Utilities itself if it were managing that portfolio?

A. No, I do not.

Q. Are you suggesting, sir, that there are types of transactions that Avista Energy can do that Avista Utility could not do?

A. No, what I'm suggesting is that I should be compensated for doing a good job, and that some of the abilities that our company has may be different than those of the Utility, but that I should be compensated for the amount of risk and effort I put in, as well as the value that I bring to the Utility and the core customers.

Q. Are you then suggesting that Avista Energy should be compensated for capturing market values which Avista Utilities is capable of capturing?

A. Some of it, if I'm doing their work, yes.

Q. And looking at the bottom of the page and continuing on to page six, you discuss basin percentage ratings, and you assert a reliability issue there; correct?

A. Yes, that's correct.

Q. Is it your understanding that Avista Utilities holds sufficient, firm interstate transportation capacity to cover its expected peak loads?

A. Its peak, yes.

Q. And am I also correct in assuming that Avista Energy only transacts with counter-parties who are well-screened when it engages in firm gas supply transactions on behalf of Avista Utilities?

A. That is correct.

Q. I'm sorry, I couldn't hear you.

A. I'm sorry.

Q. Might need to pull the microphone closer.

A. I'm trying not to cough into it.

Q. Feel free.

A. That is correct.

Q. Okay. Would you agree with me, then, that having both firm transportation with a firm gas supply with -- delivered from well-screened counter-parties should result in very high reliability?

A. I would agree with that statement, but I would point to what my testimony's discussing and why I say that there is a concern with reliability of service is any time you start to switch contracts, you know, again, you've made a commitment to a producer for this amount of gas for a period of time, and then you switch and go to another supply basin. That producer will remember that and, over time, it will be difficult to get that producer to sell to you because, one, they want a longer term relationship, they want to know that you're with them.

The other thing is that when you do switch, when you look at nominations, when you look at the gas business, it's all people involved in it. What I'm suggesting there is, as you switch things, there could be human errors that occur because you have to match up producer nominations to pipeline capacity to downstream nominations, and that's part of what my concern is when you switch, is people get used to something and if there's a change, there's a possibility that an error will occur from past experience. I know that happens.

Q. So it is your opinion, then, that avoidance of error, maintaining nice relationships with your producers, is of greater value than achieving the economic benefit that might accrue from seeking alternative supply contracts?

A. No, that's not what I'm saying, because if you look at the total the way the benchmark mechanism is designed, what it allows for is the value that I believe you're trying to get us to capture is also picked up in a different area of the benchmark mechanism. So if I don't use the capacity to move the lowest cost gas to the utility, I capture that value in the basin optimization, so you essentially do get it, you, being the Utility, gets it. So if it -- if the current or the proposed mechanism didn't have that in there, then I could understand your concern. But the way it's designed, you get that benefit.

Q. You aren't suggesting that a change in basin weightings would either change the standards that you apply in purchasing gas from well-screened counter-parties or in transporting that gas, are you?

A. If I understand the question you're asking me is, by switching the basin weightings, maybe I'll -- why don't you rephrase it. That would help me better.

Q. I'd be happy to. If the basin weightings were to be changed, that would not change the standards you apply in purchasing or transporting gas, would it?

A. No, it would not.

Q. Okay. Thank you. And isn't it also true that, unless Avista Energy changed its standards for maintaining reliability, there should be no effect on reliability from a change in basin weightings?

A. I disagree. I'd go back to my previous statement with respect to that errors can occur when you switch, and I would also say that the value that you're trying to catch is captured in other areas.

Q. Is it your opinion, then, that the firmness of the supply you obtained would have to be adjusted with basin weighting changes?

A. No, I'm not saying that.

Q. On page six, lines 13 through 22, you also discuss the impact of basin weightings on gas supply

and transportation planning; correct?
A. That's correct.
Q. And if you have a fixed basin weighting, isn't it true that Avista Energy is matching gas supply and transportation to its predetermined gas supply plan?
A. That is correct.
Q. And given that matching, isn't it true that there's very little risk as to whether or not Avista Energy is likely to meet that plan?
A. There's the risk that I would -- that I take on for the Utility at that point. It's counter-party risk, and -- so as long as I do a good job in picking the producers and the companies that we purchase from, be it a marketer or whatever, then I can control the risk, but that doesn't mean that there's no risk.
Q. Would you quantify that risk at greater than 50 percent of failure to meet your predetermined gas supply plan?
A. I guess I would look at it as it's a low probability, maybe a 10 percent risk.
Q. So in one month out of 10, you're going to fail to meet the gas supply plan that you're attempting to match supply and transportation to; is

that what you're telling us today?
A. No, what I'm telling you is that, historically, if I look at the industry and companies out there, that the majority of companies are reliable, but maybe there's a -- what we've seen historically is some companies, for whatever reason, are unable to perform, and so I was just trying to give you a level there. I mean, it's just gut feel, but it could be two percent or whatever. But I know there's failure out there.
Q. You were discussing with Mr. Trotter the purchasing of gas according to the fixed basin weights. Isn't it true that Avista Energy is not exposed to any risk if Avista Energy buys gas according to the fixed basin weights, even if those weights do not, in fact, minimize the average cost of gas?
A. We have -- there's risk. There's risk associated with if the gas that we purchased does not show up, so there's that. There's a supply risk, and --
Q. Mr. D'Arienzo, in the last month -- I'm sorry, let me make a predicate question. Have you been working for the last month?
A. Yes, I have.

Q. And during that period, have you had gas supplies that were purchased by Avista Energy for Avista Utilities not show up?

A. Not in the last month, but I have had purchases in the past from companies that are no longer in existence and had to go out and replace those supplies at my cost.

Q. Would you agree with me that Avista Energy should take on the risk of basin weights not producing the lowest gas cost if Avista Energy's going to earn rewards resulting from basin optimization?

A. Could you ask me the question again?

Q. Sure. Would you agree with me that it is appropriate for Avista Energy to assume the risk of the basin weights that the company applies in this proposed mechanism not producing the lowest gas cost to Avista Utilities if, on the other hand, Avista Energy is going to earn the rewards that result from basin optimization?

A. That's a long question. I think that, as -- hopefully this will answer your question. I think that Avista Energy should participate in the rewards of the basin weightings, and as far as supply -- bringing supply to the Utility as part of the overall compensation of the mechanism.

Q. You would agree with me, wouldn't you, that if the Commission reverted the function you're now performing for Avista Utilities to Mr. Gruber's management within the Utility, that the Utility's incentive would be to purchase gas from the lowest cost basin and return -- or I'm sorry, to retain 100 percent of the benefits that it accrues from doing so?

A. I would agree with that statement, because part of the understanding I would have with that statement is the Utility would then take the risk for all the other components, so they should get the value.

Q. Under the proposed mechanism, isn't it true that Avista Energy can meet the Tier 2 requirements by buying from the low cost basin, rather than the basin prescribed by the fixed basin weights?

A. I guess I don't understand your question.

Q. All right.

A. I'm --

Q. I'll restate it. Describe for me how it is that Avista Energy meets Avista Utilities' requirement for Tier 2 gas through the first of month purchases?

A. What we do is we take a look at, in the Tier 2, what the requirements are from each of those basins, and then we go out and we purchase that in the marketplace to meet that.

Q. And do you, in fact, purchase them according to the basin weightings or do you purchase them according to the lowest cost basin available to you at the time you make the purchases?

A. We purchased it based on the basin weightings.

Q. Strictly?

A. Mm-hmm.

Q. I'd ask you to turn now to page 10. And at the -- looking at the last colloquy there, lines 17 through 22, is my understanding correct that you're proposing that the company would purchase the forward gas and not merely a financial hedge when a storage withdrawal occurs earlier than the synthetic schedule would otherwise predetermine?

A. That is correct, for two reasons. Reliability, and it locks in the price, the hedge does, the price and reliability.

Q. Thank you. Is it true that Avista Energy uses what's called marked-to-market accounting?

A. Mark-to-market; that is correct.

Q. And this was described in Avista's response to Staff Data Request 80, which I believe has been admitted as Exhibit 111.

A. Is that 111-C?

Q. No, you know, my 111 does not have a C on it. It's Staff Data Request 80.

A. I've got it. Thank you.

JUDGE MACE: Yes, as I look at it, I'm not sure why there is a C.

MR. CROMWELL: Your Honor, if I may?

JUDGE MACE: Go ahead.

MR. CROMWELL: My copy of the exhibit list that I believe we collectively produced prior to the last prehearing conference in September had 111-C on the exhibit list, but as we discussed then, 111 was not confidential, but Exhibits 110 and 112 were confidential, and Mr. Meyer can correct me if I've gotten that wrong.

MR. MEYER: I think that's right.

JUDGE MACE: So 111 is not confidential, then. Thank you.

THE WITNESS: So that's what the C stands for.

JUDGE MACE: Right. It's as clever device.

Q. Given Avista Energy's practice of using marked-to-market accounting, it's not possible for this Commission to subsequently compare the actual cost of gas that Avista Energy incurs on behalf of Avista Utilities' customers to the daily market price, is it?

A. I think that the way the mechanism is designed, that they are able to see what the actual costs are of our purchases for the Utility. When you start with the Tier 1 hedges and those supplies, I think we've kind of walked through that, but there's auditability, we have records that we can provide, invoices. Same with the Tier 2, the first of the month. We will purchase those in the volumes and those invoices will be provided.

When we go to the Tier 3, that's the gas daily or our average. There's a spreadsheet that shows our transaction, what our average price is, and that's what -- so you'd have those invoices and be able to -- I guess you could audit the invoices, but we'd just provide a spreadsheet so you'd have that information. So I think you could see what we purchased for the Utility to meet their loads.

JUDGE MACE: Well, Mr. Cromwell, I notice that it's noon right now.

MR. CROMWELL: Oh, I apologize.

JUDGE MACE: How much cross do you have left of the witness?

MR. CROMWELL: Fifteen, 20 minutes, perhaps.

JUDGE MACE: We'll take our lunch recess, and we'll resume at 1:30.

MR. CROMWELL: Thank you, Mr. D'Arienzo.

THE WITNESS: Thank you.

(Lunch recess taken.)

JUDGE MACE: I believe, Mr. Cromwell, you were cross-examining Mr. D'Arienzo when we recessed for lunch.

MR. CROMWELL: Yes, thank you, Your Honor.

Q. Mr. D'Arienzo, do you have your MED-5, what's been admitted as Exhibit 105, available to you?

A. Yes, I do.

Q. And in reviewing that, is it -- excuse me. Let me restate that. Did you perform the underlying analysis represented by this exhibit?

A. No, someone in my company did for me.

Q. And who was that?

A. Blaine French.

Q. And is Mr. French in the room?

A. Yes, he is.

Q. Is he the gentleman in the glasses and

goatee raising his right hand at the moment?
A. Yes.
Q. Thank you. And when did Mr. French produce this analysis for you?
A. I'm not sure. I look at the date at the bottom. August 18th, so somewhere -- I would assume somewhere around there.
Q. Just so we're clear on the record, the analysis was produced for the purpose of your rebuttal testimony. It was not produced for some other purpose and then imported?
A. That's correct.
Q. And this analysis compares Avista Energy's performance to the gas daily index prices in the year of 2002?
A. Yes, it does.
Q. And your analysis concluded that Avista Energy's transactions tracked the gas daily prices in 2002; correct?
A. That is correct.
Q. Prior to filing your rebuttal testimony and producing this exhibit to the Commission, were you aware of concerns that had been raised regarding a manipulation of the gas daily index prices during the 2002 time frame you analyzed here?

A. I was aware of -- that there was discussion in the media about the possible manipulation of prices, be it in the power market or gas market.

Q. Prior to filing your rebuttal testimony in producing this exhibit to the Commission, had you reviewed any of the Federal Energy Regulatory Commission Staff reports, which have been admitted as Exhibits 113, 114, 115 and 116?

A. No, I had not.

Q. So then it would also be correct to assume that you've made no adjustments to this analysis or to your rebuttal testimony to take into account any intentional manipulation of the gas daily indices that might have occurred in 2002?

A. That is correct.

Q. Can you tell us who William H. Taylor is?

A. Bill -- William H. Taylor was at one time a -- I believe a VP for Avista Energy when we had a Houston office.

Q. Would you accept, subject to check, that in the 1998 time frame, Mr. Taylor was, in fact, the Avista Energy vice president of trading?

A. Subject to check.

Q. Would you also accept, subject to check, that on September 30th of this year, the commodity futures trading Commission entered an order making findings and imposing remedial sanctions as to Respondent Taylor in CFTC Docket Number 01-23?

MR. MEYER: Your Honor, I'll object to this line of questioning. I don't see the relevancy of what may have been agreed to for some prior period by a former employee of Avista Energy, how that relates specifically to the issues before you today, so I object to this line of questioning.

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: I can lay a predicate foundational question, if you like.

JUDGE MACE: Go ahead.

Q. Mr. D'Arienzo, are you aware of ongoing investigations by the CFTC, the SEC, or the FERC regarding the gas indices markets?

A. Yes, I am, and I'm also aware that, at this point, it's my understanding that there have been no formal findings published, as far as indexes and were they manipulated, how much they were manipulated. As Mr. Cromwell brought up, he mentioned several of these reports, and I did take a look at those and I read those reports and I found them very interesting. In fact, I found that they supported many of my conclusions as far as the need for indexes, the needs that the market operates efficiently, and that there are -- that if the market does operate efficiently and how it has deregulated over the last 18 years, natural gas prices have come down. They've come down as much as 40 percent because of allowing the market to operate, which customers have benefited with.

So as I went through that, I saw that, granted, you read in the media and with the FERC and things like that, that there have been findings, or maybe not findings, but studies or investigations on improper behavior by different people in the industry. However, I know that there's been none of that in my company as far as the natural gas and what we do, and I felt comfortable with that.

The other thing is we're focused on the business of supplying gas to the region. And unfortunately, we're not a very large company when it gets right down to a national player. We're a smaller company. And depending on what the FERC determines, the CFTC and some of those, we're going to have to live with that.

And so I'm aware of it and we track it, but did it change what I'm doing in my business? No, because I believe that we're honestly doing things that -- it may change some of the reporting, which I think will be better in the long run, but it doesn't change why I should look at this and see, Oh, jeez, were some of these prices manipulated? No. These are our actual costs, so I feel very comfortable with that.

I'm sorry to go on, but it's kind of a hot button for me.

Q. I understand that. I believe I heard you say a moment ago that you were never aware of that or -- I may need to have the record read back, but you said never in regards to your company. Were you speaking regarding Avista Energy at all or regarding Avista Energy since you arrived in -- I believe it was 1998?

A. You might want to read the record back, but the never statement -- and maybe I'll just clarify that. It's my personal opinion that, under my direction and what we do at the Avista Spokane office that I would have control over, we never manipulated prices.

Q. When did you arrive and initiate your employment with Avista Energy?

A. I was one of the first employees back when the company was formed. I was one of the original six. So it was 1997, March, I think.

Q. All right. And so when you said no one in Avista Energy, you were talking about Avista Energy Spokane. You were excluding Avista Energy Houston?

A. What I was saying is, of my understanding, of what I'm privy to and what I know, I've never seen a case of manipulated -- what Mr. Taylor or whatever, I can't comment on that, because I'm not privy to that information.

Q. Is there anyone in the room who would be privy to that information?

A. I don't believe so.

Q. You'll -- I apologize in advance if I mispronounce the name, but do you know who Robert Kristufek is?

A. I know who he was, or is, but not very much. Again, that's a Houston individual, out of that office.

Q. And Michael Griswold?

A. He was a trader on the power side, and he was located in Spokane.

Q. Okay. And you're aware, also, that the CFTC has settled related charges against Mr. Griswold, who you now admit was in the Spokane office regarding his actions in the 2001-2002 time frame?

A. I'm not sure what Mr. Griswold settled on.

Q. Who's Thomas Johns?
A. He was also a Spokane VP at one time.
Q. So just so the record's clear, he was an Avista Energy vice president in that time frame?
A. That's correct.
Q. Has Avista Energy closed its Houston office?
A. Yes, we have.
Q. When did you close the Houston office?
A. I don't remember. I mean, it's been a couple of years. Maybe three years ago.
Q. So 2000?
A. Could be. I mean, they run together for me. Unfortunately, I -- subject to check, I could find out and get you that information.
MR. CROMWELL: If I could make a record requisition request just for that date when the Houston office was closed?
JUDGE MACE: That would be Record Requisition Number 1.
Q. Mr. D'Arienzo, was the closing of the Avista Energy Houston office part of a larger scaling back effort, or was it an isolated decision?
A. I believe it was part of a larger scaling back. Eventually -- and I think what happened is the leadership that we had in place at the time looked to

Avista Energy as we were going to go national, and so they opened up a Houston Office. We also had a Boston office and looked at expanding the business, trying to replicate what we were able to do in the Pacific Northwest, where we had been very successful. We purchased another company, Vitol, and some of their leadership management came with that.

What we found was that it took a lot of capital, there were a lot of credit risks and things like that, and really we could not -- we didn't have the expertise, nor could we replicate what we were doing in the Pacific Northwest, and so what it became was a decision to eliminate that company, or that part of it and come back to the Pacific Northwest, the WSCC, where, one, our expertise is, and we had the ability to transact.

MR. CROMWELL: Thank you. Nothing further for Mr. D'Arienzo. Thank you for your time, sir.

THE WITNESS: You're welcome.

CHAIRWOMAN SHOWALTER: Can we take a one-minute pause?

JUDGE MACE: Sure.

CHAIRWOMAN SHOWALTER: Is it my turn?

JUDGE MACE: Yes, it is.

CHAIRWOMAN SHOWALTER: Thanks.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. I want to get a sense of proportion, and what I'm trying to get a sense of is the relative dollar value in some manner of the Tier 3 activities versus the whole amount of revenue that you would receive from Avista Utilities.

In other words, if you assume, over the course of a year, that you executed the 50 percent Tier 1 and executed Tier 2, and that the $3 million payment is made one way and the 900,000 the other, then there's a variable amount split 80/20, based on different functions, but over the course of a year, what is the approximate entire amount of revenue you would be receiving from Avista Utilities, and what is a estimate of the amount that could go one way or the other between the two entities?

A. Maybe if I could -- the way I could answer that is if you look at the way the benchmark mechanism is structured, we get the $900,000 payment for providing all these different services, and when I look at the Tier 3, that component, to me, historically, I look at that as that's something where, more times than not, I'll lose money on that. And historically, that has been the case.

When I look at the total compensation, when I put them all together, I think that the 900,000 I would make, that would obviously offset some of my other costs, so would I make a pure 900,000, no, probably half of that, but I think I could make 900,000 up to, say, $1.3 million because of the capacity release and the off-system sales.

And when I look at the total package of the benchmark mechanism and the 80/20 sharing on all of these, I look at it as I'll make somewhere around a million dollars a year. Some years, I may only make 700,000 or 600,000, depending on what type of volatility we see in the Tier 3 and what we have to do to cover those costs compared to the first of the month, to other times where I'll make money on the capacity optimization, the capacity release, off-system sales to offset that.

So to me, the magnitude of this is it's right around a million dollars, and it could be as much as maybe a million-three if we do well on the capacity and the off-system sales, because we get a percentage of that.

Q.   I realize now I probably asked for an answer that's already in the evidence, which is the estimate of the benefit to Avista Energy and the benefit to

Avista Utilities.

A. Right.

Q. And so that was the one point -- the one million?

A. Yeah, it's about a million.

Q. To Avista Energy? And --

A. And the 2.5 million to the Utility.

Q. Okay. All right. Well, still, then, that's a total of 3.5 million in some kind of benefit compared to what for the whole volume of dollar value of what is at issue here? All of the Tier 1, Tier 2, plus $3 million?

A. If you're looking at the cost of the 70 -- $58 million and the $4.5 million and the 13.6, so of the total $76 million that's out there, we're looking at --

Q. All right.

A. Is that what you're trying to get to?

Q. Yeah, I apologize, because I think this is all in the record. And I was just thinking of the question, but I realize I just had to go to a record and look at it.

A. So when you look at the margin, I guess that's another way to look at it. When you look at the margin for this, it's pretty small margin that we would make when you look at the total dollars that are out there, the risk that's out there, the work that's required. And that's why I think credit is a really big issue. That's why I think counter-party, you know, liquidity, things like that are big issues, because when you look at the margin, it only takes one or two small little blips and I'm working for free, and that's not a good thing.

And I think what has happened is, over the last several years, we've gotten better at that. The market's changed so there may be less opportunity. I'm hopeful in the future that we've designed this with the 80/20 that the Utility will save a lot of money and my 20 percent will be something that we feel very good about. But again, do I see it $6 million for us, no. Because of the way it's designed with the 80/20, we're only getting 20 percent of every dollar after we've hit a certain target, like on the $3 million guarantee, so I think it's a good business.

Q. There was somewhere in the record that talks about you having a different risk profile than Avista Utilities. And how do you characterize your risk profile compared to Avista Utilities?

A. When I look at Avista Energy and what we do, we are set up to trade around physical assets, and that's something that we do. We have some of our own transportation, we utilize some of the Utilities' transportation, you know, which was captured in the benchmark. Our customers, we use some of their -- but we also take speculative positions, so at the end of the day, I will have on my books sometimes, if I believe the price of natural gas is going to go down, I may short the market, go short, and hope to capture that and capture that revenue. So that's something that I will speculate.

The Utility, I don't believe, does that, nor do I think it's prudent that they should, because trading, at the end of the day, is a zero sum game, and we have been successful the last 13 quarters, but it just takes -- well, like in November of 2000, December of 2000, you could lose a substantial amount of dollars. So I think we take a little different approach.

Q. When you say you've been successful in the last 13 quarters, what is your measurement of that?

A. Profits compared to our costs. Avista Energy has been -- when you combine the electric and the gas, we've been profitable all but maybe one year out of the last five.

Q. So successful means a profit above zero?
A. Yes.
CHAIRWOMAN SHOWALTER: Thank you.
JUDGE MACE: Commissioner Hemstad.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:
Q. In your response to questions from Mr. Trotter, as I understood the question and your response, Avista Energy buys based on the basin weightings, even when you could obtain a lower price by breaking away from that. Is that my -- is my understanding correct as to how you answered that?
A. Under the current -- the proposed mechanism, we would. Under the current mechanism, we will buy a certain percentage according to the basin weightings, but we may, once we get to the actual delivery, we may sell some of that out and bring in, as Mr. Trotter showed, bring gas in from a different location to serve the Utility.
Q. And that's reflected in the questions and answers about the 33.2 percent as against the 18 percent?
A. That's correct. And that was one way that, as we started to manage this benchmark, you know,

because when you look at our history of managing the benchmark and how much money we make, we basically got ran over in November, lost a tremendous amount of money because of the intra-month volatility that I had no idea was there and I don't think anybody in this room could have predicted that prices would do that. And so we had this deal and then we tried to look at, okay, are there other ways that we can recoup some dollars more efficiently operating this toolbox, more efficiently looking at, okay, are there things that we can do that will bring value to Avista Energy, and basin optimization was one of those.

Q. I guess I'm still not fully grasping how the mechanics work. Why wouldn't you be buying from that basin which has the lowest price?

A. Oh, we do, we do. Maybe I'm -- what we'll do is -- you know, the other thing, there's a lot of different components, and what we look at from Avista Energy, the first thing is reliability. So I've got to make sure to buy a certain amount of supply from each of these basins to match the transportation, to be able to serve the Utility, to have that reliability, so I'll go out and do that. But then, once I get there -- and by getting there, once I get to the month and I'm starting to deliver, if I can

bring in Rockies gas and still have the same reliability, then I'll go ahead and do that. So I rearrange the portfolio.
And that's something that we put in here to try to capture. You have the basin optimization, you have the forward, and then you actually have the daily. And so that's what we've done. Maybe I should grab an exhibit.
MR. MEYER: I don't know if they're going to be able to see that. That is Exhibit 5, if you want the Commissioners to follow.
THE WITNESS: Yeah. And really --
MR. MEYER: Just wait a minute, please, until they have that in front of them.
THE WITNESS: Okay. What we've done is, you know, we've developed this mechanism over time with, as the industry changed, we learned about -- Staff gave us some good input, we put some input, but what I was trying to get to is, under the basin optimization, we have the forward basin opt, and that's you go out, take a look, you buy gas in those different basins and, because of that, they have a certain value. And we'll go ahead and do that.
Once we get to the prompt month, we're right there at delivery, then we'll take a look, and if

it's cheaper to bring in gas from a different location and we have the same reliability, we'll go ahead and do that, and that's the daily basin optimization, which, again, is 80/20 sharing.

And so what we've been able to do historically is be able to capture some of that. But what requires the daily opt and why Avista Energy can do a better job of it, is all of a sudden you're rearranging all your supply. So I bring liquidity, I bring counter-parties to this so that we can go ahead and transact that. And that's something Utility doesn't have, nor do they have the size.

I have customers in Seattle, I have customers in Portland, all over, I have counter-parties that I'm going to trade at different hubs, so I can arrange the supply to get it there to capture the most value, which is a lot different than what the Utility could do or would do. And I think that's where, when we talk about scale, Avista Energy and the size of Avista Utility, they're about eight percent of our physical and they're about three percent of our total trading.

And you know, I try not to make this more complicated than it is, but you can either buy gas at a hub, you can transport gas to a hub, and so, you know, even though we may not have had as much transportation, if we buy gas in the right location, it's as if you have transportation.

Q. Well, all right. Is it fair to say, then, an elaboration on your response to Mr. Trotter's question would be that your initial purchases are based on weighting, but you make later adjustments based upon price?

A. That's correct, price and reliability.

Q. Yes.

A. Mm-hmm.

Q. I believe you indicated that you have one other local distribution company that you buy for, and that's Ellensburg?

A. That's correct.

Q. Can you give me a ballpark estimate of the percentage of your total sales that they represent?

A. They're a very small customer. They're less than one percent.

Q. Sure. I'm sure it's considerably less, aren't they --

A. Yes, yes.

Q. -- if Avista is eight percent of the physical?

A. The interesting thing about Ellensburg, they went through -- we've been serving them for over three years now, and they went through a similar process that we've seen with the Utility, at Avista Utilities, that is. Originally what they did is they didn't have the expertise to be able to meet all the markets, so what they did is they wanted just a fixed price. They said, Fix our price for us and give us whatever that number is, and then you can take all of our assets and manage them, and as long as I need gas, this will be my price of the gas for my base. They kind of gave us a load projection, like the Utility, and then they said anything above that -- we worked out an arrangement that was a gas daily, and they have storage and stuff. So we gave them a fixed price they felt comfortable with, their customers, they felt -- the university, things like that, and then -- so we did that the first couple years.

And then this last year, what they did is they said, Well, as we were going through this -- and they went out through an RFP process, they went out and they said, Well, maybe we're leaving some dollars on the table. Maybe there's whatever. And what I told them is, based on their assets, there wasn't a lot of value there on the transportation, there wasn't a lot of value on their storage. It was a small piece, but, again, so what we did is we came up with an arrangement real similar to this in that we have an 80/20 sharing mechanism on these assets and then we went out and we hedged gas for them and then there were other gas daily and we buy back at the daily.

So I think this is common. What we're seeing in the industry is just the way it's evolving and people are getting a better understanding of it, that they're saying, Well, yeah, there's some value here, but yet still incent someone like me to want to go ahead and do this business.

Q. Do you see any problems for Ellensburg when it comes to auditing your activities?

A. No, they felt very comfortable with what we do. When I do a transaction, put a hedge in place, buy them fixed price gas or whatever, I send them a confirmation and they, in turn, sign that confirmation on the day. But they've not asked for, you know, a matching trade on the other side, but they feel very comfortable. I think why they feel comfortable is it's at market. It's kind of what they're seeing out there, if they went with IGI or if they went with BP or somebody like that. We're right there, and so they're saying it passes the reasonableness test to them.

And I think that's the good and the bad about this benchmark is it's gotten -- in order to have the transparency, there are a lot of pieces and there's a lot of information, but when it really gets down to it, you look at the load, we buy a certain amount to give them reliability, and we buy that at a fixed price. We buy another certain amount that gives us some access to the markets so maybe we're not going to hit the highs or the lows, but there's some access, that's your first of the month. And then, when you go above that, you're going to buy that gas daily, rather than paying a premium for that, because the reality is you're kind of self-insuring yourself. There aren't that many times you're going to hit that really high peak, so why would you pay that premium for that.

And so you've got a lot of components, but the reality is you're trying to get the least cost price of gas based on what you see in the market, and the markets change. But really, there's fixed price, there's first of the month, but at the end of the day, they all become a fixed price. So what you're trying to do is stack it so you get your least cost fixed price, have the reliability, and so that's really -- when I look at it, that's the way I look at it, is are we better off as a ratepayer.

COMMISSIONER HEMSTAD: Thank you. That's all I have.

JUDGE MACE: Commissioner Oshie.

CHAIRWOMAN SHOWALTER: Bench Request Number 3, a copy of the contract with Ellensburg. I presume it's a public record?

MR. MEYER: I assume that to be the case.

THE WITNESS: Yeah, I think we've provided one in the data request.

JUDGE MACE: Any of the parties aware of what data request that might be?

THE WITNESS: That was our original, and now we have the new one, so I could get you the new one, too.

MR. MEYER: In any event, we'll provide it. So that's number 3, I guess?

JUDGE MACE: Yes, it is 3.

E X A M I N A T I O N

BY COMMISSIONER OSHIE:

Q. I just want to follow-up on the question that was asked by Commissioner Hemstad, and I want to make sure I understand the circumstances in which the

Avista Energy would look to the least cost basin to provide the resource to the Utility. And I guess, from my understanding of the case that's presented by the Utility is -- and maybe the discussion, the form of the discussion that we've had, is that that circumstance would occur the majority -- I'm not going to -- let's not isolate some or not consider some isolated occurrences, but the majority of the time that would happen if the Utility were out of balance and were requesting more of the resource.

And so at that point, it seems as if the Energy would either look to -- it would have a couple of options, I suppose. It could follow the basin weightings and just provide a generic resource based on that and price it that way, or it would look to, at least what I understood from what you said, is it would look to the least cost basin, it wouldn't be bound by the basin weightings, but would look to the least cost basin and then provide that resource at the price of that basin, and the Utility would then receive that price from Energy. Is that -- do I have --

A. Yeah, I think what ends up, as far as I think what's getting somewhat lost is when you switch to that lowest cost basin, all right, you've now used transport that you may have released or you would have to hold onto to be able to take advantage of something like that, and so you could do that.

However, I think what we've designed with the mechanism -- in fact, I know what we've designed with the mechanism is you set up a certain percentage of the load based on this least cost basins, you're going to capture that, and then, when the load changes, we'll go out and there's a mechanism in place, it's either gas daily or whatever, and that's what you'll pay. You'll get the gas, but what ends up happening is you have other components that you're going to derive value from that will offset this gas cost.

So there's two ways you can do it. One, you could use these assets to get this here or you could use those assets out in the market, get the value, and then just keep doing what you were doing and offset it. I hope that answers your question.

Q. Well, I mean, it does in one respect, I mean, in that it enlightens me as to the different -- to the decision that has to be made by Energy when it provides the resource. I guess it doesn't really, to me, answer the question that was asked by Mr. Trotter, I thought, and also Commissioner Hemstad, that -- and perhaps you have to put it in simpler terms, but I understood you to say that when Energy buys gas -- let's use the Rockies as an example, that if their -- if the Rockies would be the least expensive basin and the Utility was demanding gas for to meet the daily load, then Energy would provide that resource from that least expensive basin and provide -- and that cost would flow through to the Utility?

A. That --

Q. And if that's -- that's what I thought you said?

A. Yeah.

Q. But then, what you've just -- maybe if I could restate what I believe you said in your earlier response to my question was that that may not be true, because if you balance out the other -- in all circumstances, because if the benefits from the other components, if you could -- if the benefits from the release of capacity would then offset the cost from whatever basin you would buy it from, then that would provide the least cost to the Utility, which would be passed through to it.

A. Unfortunately, it's a little bit of both. What you end up doing is you go ahead and buy the gas. And what we'll do is we'll take a look, depending on -- because there are times, it's not like we've released all the capacity or that you have none of the transportation. So if we have transportation available or we're able to get delivery from a different basin like the Rockies, we'll go ahead and do that. That's the daily basin opt that -- so we'll go ahead, like I said to Commissioner Hemstad, we will pull in more supply from there.

I was just saying, moreover, all -- so you do it all. It's not just one or the other, and you do it in different levels of all that.

Q. Well, when energy pulls in the supply from another basin, does it pass through the cost of that supply to the Utility -- or from the least cost basin?

A. In the proposed, that would go into the calculation, yeah. That's part of the 80/20, so you would capture that.

Q. How much of the -- of Energy's transmission capacity is made up of what it receives from the Utility?

A. I know I have a data request here. Just a second. I think it's about 20 percent when it gets right down to it.

Q. Now, is it --

MR. MEYER: DR 119, if that will help the Witness.

JUDGE MACE: That's not Exhibit 119?

MR. MEYER: No, it's Data Request 119.

THE WITNESS: I've got it in here.

MR. MEYER: May I approach the Witness?

JUDGE MACE: Yes.

THE WITNESS: Yeah, about 20 percent.

Q. Is that the -- the 20 percent reflect all of the transmission capacity that the Utility has turned over management of to Energy, or does that -- or is that just the basin weightings that are prescribed by the SOG?

A. What that is is that's a number -- it's the amount of capacity that would be available to Avista Energy to utilize. That doesn't have a requirement back to the Utility. So if I took the Utility's transportation, look at their resource, see what I need to use to supply to them, then I look at their excess, I get about 20 percent that I could use.

CHAIRWOMAN SHOWALTER: Twenty percent of theirs or 20 percent of yours?

THE WITNESS: Twenty percent of what -- my firm transmission that I have.

Q. And that -- and the Utilities' -- I'll call it demand -- is based upon the basin weightings?

A. Their demand is based upon their usage.

Q. Yes, but -- and then, so the basin weightings have nothing to do with it. Is that just a pricing scheme?

A. No, no.

Q. In other words, if you weight the basins, because it may have -- for example, I don't know how to, you know, 100,000 decatherms of capacity, but the basin weighting is 60 percent, so would that be 60,000 decatherms of available?

A. No, the basin weightings come about based on the available transportation that the Utility holds from each of those areas of supply. And that -- that's where the basin weightings come from when you look at what it takes to supply the Utility.

Q. Well, I guess I don't understand that, because it seemed to me that the basin weighting -- for example, if you own 25 percent, and I'm just trying to figure out how it's judged, 25 percent of something from the Rockies, but the basin weighting is 18 percent. So how does that -- I mean, what does it own 25 percent of, the capacity on the pipeline from the Rockies, or 25 percent of its annual load, it owns enough capacity on the Rockies pipeline to meet that?

A. When you look at all of their transportation contracts, 25 percent of the supply, which would utilize those transportation contracts, comes from the Rocky Mountains. That's what --

CHAIRWOMAN SHOWALTER: In other words, at any given time, if Avista's demand is 100 percent, then 18 percent of it will be met from the Rockies and X percent from another hub and X percent from another hub, all adding up to 100 percent. The weightings is what percent of the load will be met from a certain hub?

THE WITNESS: Right.

CHAIRWOMAN SHOWALTER: As a starting point, and then you might step in at a later point and rearrange that?

THE WITNESS: If we could look at Exhibit 4, this might help explain it. This is the Utilities' load. Do we have the --

UNIDENTIFIED SPEAKER: It's behind you. It's on the wall.

THE WITNESS: That's not what I want.

MR. MEYER: Which one are you looking for?

THE WITNESS: It has the basin transportation. It's the circle one with --

MR. MEYER: Don't have that, but what's the exhibit number?

MR. NORWOOD: It's in Gruber's testimony.

MR. MEYER: Just a moment, Your Honor.

COMMISSIONER OSHIE: I believe it's Exhibit 52, page four.

MR. MEYER: Thank you.

THE WITNESS: It's this one. Everybody there? What this Exhibit 2 shows, in decatherms, are the available transportation capacity that we have available, Avista Utilities has to serve its Washington load. Those are transportation contracts. So it has 18,000 a day it can pull from Sumas, 55,000 a day from AECO, and 23,000, approximately, from the Rockies. That's the transportation that it needs -- that it uses.

Here's the load. What happens is, in order to meet the load on a day like in here, in December and January, we're pulling -- we're using all the transportation from each of those locations to meet that load. And so the basin weightings of 18, 57 and 25, that's what it would be.

Now, what happens is we come into the

summer, loads are off. Now what we can do is we can bring in a higher percentage of the load from Rockies, because now the Rockies is down. So now you see like a 33 percent or whatever. So that's where it gets a little bit confusing, and I apologize for not doing a very good job of that.

But depending on where we are, the percentages that we can pull from the basins will change to take advantage of the lower cost. And so we watch this and, as you go through, depending on what the load is, we'll go ahead and do that to capture that, and that's in the 80/20 that you get.

So at the beginning of the year, we look at this, we buy the gas this way. Then, when we get here, depending on what the loads are and the prices, we'll go ahead and do that, upgrade that, get that value, and it's an 80/20 sharing, where in the past Avista Energy got all of that benefit, but it also took all of the risk, depending on what was going on here. And at the end of the day, the intra-month volatility was much more expensive than the value you captured here. I hope that helps.

Q. It does. It helps to understand, I guess, the, you know, the buying patterns of Energy in meeting the Utilities' load.

A. Yeah.

Q. Mr. D'Arienzo, what is -- I guess I asked Mr. Gruber this question, and maybe I'll let you explain for yourself what your role in the Strategic Oversight Group is?

A. I'm one of the members of the Strategic Oversight Group. What I do is my role is I'm there to provide market information and what I'm seeing out in the market as far as trading, prices, I bring information as far as what we've gathered with respect to -- we have two weather services in the Pacific Northwest. Weather plays a huge part in the energy dynamics, because if we don't have snowpack, you're going to have gas-fired generation going. I mean, that's just the reality of it. So we watch the weather.

And so my job is to bring that information, to bring a different opinion -- and by a different opinion, that is an opinion that's formed in a different location based on different, you know, things that come into my office. And so when I go to the Strategic Oversight Group, we take a look at the benchmark and what we need to do, be it hedges, and we have a certain window. And so I'll come in with the opinion that prices are inflated due to several types of factors, what we're seeing in the industry, and I'll come in and say, Well, I don't want to hedge now. I think we should wait. I think prices are going to come down.

And so my job is to come in with an independent voice and show how I think we should be -- when we should hedge, when we shouldn't hedge, what risk we have and not.

Q. And is Mr. Gruber, do you consider him to be the ultimate decision-maker of the SOG?

A. I do.

Q. And if the hedge were -- if a hedge were purchased based on the SOG's recommendation, is it purchased by Energy or the Utility?

A. Energy does the trade. We go ahead and go out there and do that. And it's interesting that, you know, I was thinking about that when Bob was describing the SOG, and I used to work at the Utility. I started with the Utility in the early '80s. Came up through answering telephones all the way up through marketing, worked for a sub, Development Associates, sold us to BC Gas. So I kind of have a flavor for both. And worked with Bob, worked with Pat Gorton for years.

So we get in these, and I respect them and I understand their views, and at times I forget some of the challenges that they have. So when we get in these, they can be pretty -- we come to a lot of consensus, but that's not without a lot of struggle, because, frankly, I may have a view, and my view is, you know, prices are way too high, I do not want to buy, and I will, you know, push them. We don't want to buy, we don't want to buy. And Bob's conversation might be, I'm getting pressure from upper management that wants to make sure that we don't have a November again. So you sure we -- come on, you know, it's dropped for a week.

So this debate goes on and on and then we pick -- come up with a target depending on that debate, and then we'll go ahead and stick to that. And frankly, there are times I walk out of that room thinking, you know, I didn't do a good enough job selling him on this, because this is the target, I can't get it through to him, but -- and then, as we get there, start to see it, then we'll have another discussion. And I'm sure he goes away and Pat Gorton goes away thinking, you know, What does this guy think he's doing. But that's how it works.

But I know, at the end of the day, he's the guy that makes the decision and he's the guy that's got to -- when Gary Ely comes down and says we have to go in for a 12 percent rate increase, he's going to get heat and I'm going to get heat, because Gary Ely is also the CEO of our company. And we have risk management meetings, and he's in that, and there's not one that doesn't come up where -- where are you guys at on the hedges, how are you doing, how do you think it's going to impact the rates.

You know, so I know my credibility and his credibility and David's is on the line. So I mean, it's -- it's fun, but it's stressful. And because I've said times, Let's wait, and it's gone -- they were right. But then there have been times where I've been right, and I make sure to point that out.

Q. Sounds like a well-functioning group.

A. Oh, yeah, it is.

COMMISSIONER OSHIE: All right. Well, thank you, Mr. D'Arienzo.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. I've got a follow-up. If you could go back to Exhibit 52, page four, this is that pie chart or the graphic of your percentages.

A. Oh, mm-hmm.

Q. I just want to make sure that the record is clear, as well as my head. Now, my understanding is that these percentages reflect how you, in fact, buy Tier 1 and I believe Tier 2; is that correct?

A. These percentages go into how we purchase when we do purchase the Tier 1 and Tier 2. It would be based on each year, when these are set, then we do go in and buy that based on those percentages as they're set.

Q. But the percentages are not determined on the day you buy; they're determined in advance?

A. That is correct.

Q. For both Tier 1 and Tier 2?

A. That's correct.

Q. All right. And then, every day, if you can take advantage of differences among these three hubs and rearrange your whole portfolio, including Avista Utilities, you will do so and share the Avista Utility portion 80/20?

A. That is correct.

Q. Okay. And that you do this regardless of whether you need more on that day for Avista Utilities? You will do it depending on the relative difference in price of these hubs relative to what you bought originally?

A. That's correct. Because what -- what this does is this sets up, when we set up the original plan, at that time, the way these weightings come about is at that time, that's the lowest cost percentages to serve the load when we look forward. So we say, Yeah, that's what we're going to do. Then, when we actually get there, if we have the ability to upgrade that with the proposed, I'm doing everything I can to drive that, because what that ends up doing is I get a dollar out of every five to do that, so I'm incented to upgrade.

That's the way I look at this. You set a plan, there's your cost of gas, now it's in place, now you go out there and upgrade this. By upgrade it, you go out there and get a way to reduce our costs. Sell more transportation to off-system sales, bring in -- if you don't have the off-system sales, make sure to be bringing in more supply this way, so you're out there trying to upgrade this so that you get the least --

Q. You're getting beyond my question.

A. Okay.

Q. You really are, so -- and you have confused me again.

A. Oh.

Q. Now, if we approve this plan, this mechanism, let's say it is next October 1st, and you're going to be buying for the month of October, do you follow this exact weighting on October 1st for the month of October 1st, or do you talk to your colleagues and vary from 18 percent, 15 percent, 25 percent on October 1st for the month of October because there's a different advantage?

A. Yes, we will.

Q. You will vary from it?

A. We'll vary from it to bring in lower cost gas, as long as the reliability is not impacted and we have the transportation to do it, so we will do that.

Q. And likewise, then, for the Tier 1, when it comes to the day to buy a Tier 1 purchase?

A. You already have -- the gas is already purchased. The Tier 1 is already purchased.

Q. So that is purchased according to these percentages, Tier 1?

A. Mm-hmm.

Q. But --

A. But what -- okay.

Q. But Tier 2 is not necessarily going to be according to these percentages, because you will take

a look on that on the day you buy; is that correct?
A. What we'll do is we'll buy the Tier 1 and the Tier 2 based on the percentages, but when we get to that month, if I can sell -- say we have Sumas gas and Rockies is cheaper, I'll go out and sell Sumas gas, and it might be Tier 1, it might be Tier 2, I'll sell that gas and then I'll purchase Rockies supply, and that's how I get the lower cost. So I sell that out and then I get a lower cost and bring in the Rockies.
Q. All right. So now I'm back to the first way I thought it was. Tier 1 and Tier 2 are purchased according to these percentages, period; right?
A. Mm-hmm.
Q. And then the adjustments you make later are the basin optimization adjustments, not the initial purchases?
A. That's correct. That would be your forward basin.
Q. All right. And then, likewise, the daily is only that?
A. Right.
Q. And in essence, you'd make a judgment?
A. Mm-hmm.
Q. Okay.

A. Sorry about that.

CHAIRWOMAN SHOWALTER: I thought I had one more question, but I forgot it. Thanks.

JUDGE MACE: All right. Back to 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. Initially you were asked a question or two about counter-party risk, I think in your exchange with Public Counsel. Do you recall that?

A. Yes, I do.

Q. How real is counter-party risk?

A. Counter-party risk is very real. In fact, that's something we have that we manage -- we spend a lot of time managing that, and the real risk is if a counter-party does go away, we are on the hook. Avista Energy has to go out and either get another supply or, you know, use some of its supply to make up for if a counter-party does not come about. It's very complex.

I could show you -- if you came to our offices, I could show you -- we have a pink sheet. And the pink sheets are all the credit, and it has all our counter-parties, and there might be 90 counter-parties on there, and it's to the point where I may be able to purchase gas from a counter-party only the first three months, because of our positions and our risk. I may only buy -- they're open for me to buy the first three months, or they may only be open for me to sell to, depending on what my exposure is to them, or I may be able to sell to them six months and out.

So there's a lot of thought and a lot of analysis that goes into counter-party risk, and it's a real risk. It's something that I think any business out there looks at and says there's a percentage of your business that could go away. Is it one percent, is it three percent, whatever, and it will be a cost, so you better manage your counter-party risk.

Q. Under the mechanism, is the consequence of being wrong in your assessment about counter-party risk that you, at Avista Energy, eat it?

A. Yes, that is the case. That's one of the risks, that's one of the values that I think the benchmark that we bring to the Utility is is I'm stepping in there and saying, I'll take that risk. Allow me to participate in this and I'll take that risk.

Q. Also, Public Counsel asked you about mark-to-market accounting. Does mark-to-market accounting have any bearing on the issues here?

A. No, it does not, because everything that we've priced is based on the market, it's based on an index. Mark-to-market is only a way for us to value what our actual positions are, our whole business.

Q. Moving on, Staff asked you, with reference to, and I don't know that we need to turn to it necessarily, but your Exhibit 104, and walked you through a series of questions about the -- and in doing so, seemed to question the adequacy of the reports in terms of whether or not they provide information on the actual value of the transactions. Do you recall that exchange?

A. Yes, I do.

Q. Okay. And are these reports that are provided periodically as part of the audit process to Staff?

A. Yes, they are. They've been provided to the Staff and -- for the last several years.

Q. And can you think of an instance where the Staff has ever followed up and asked you a follow-on question to get more guidance or more information about what's behind those reports insofar as the value of the transactions is concerned?

A. No, they have not.

Q. In terms of more generally, have you ever denied a request for additional follow-up audit material or documentation from Staff?

A. No, we have not. In fact, we've invited them multiple times to come over to our shop, and Mike and some of his counter-parties -- or co-workers have come over, and we've been an open shop. We let them sit right on the floor, watch how we trade to try to get a sense for it, because I think, you know, we want this benchmark to continue, it's evolved, and they need to -- maybe if they have a better understanding what we're trying to do, we can reach an agreement and consensus of what they need.

So we've invited them over, they've come over, show up at -- because we start trading at about 5:30, 6:00 in the morning. They come in and we sit down and try to walk through it, same with Hank and Mert and the other people who have been over. So -- but it's been a while.

Q. Are you prepared to adjust your reporting documentation, et cetera, in any way that satisfies the information needs of Staff?

A. Yes, and I think we've shown that.

Q. Would you get out two exhibits now? One is Exhibit 55-C, please. And this is attached to Mr. Gruber's testimony. It had been preliminarily marked as RHG-5-C. Let me know when you're there.

A. 55-C?

Q. Yes.

A. Okay.

Q. Also, would you get out benchmark -- I'm sorry, Bench Request Number 1?

A. I've got it right here. Okay.

Q. Okay. We'll take them in the order I presented them. First, let's turn to Exhibit 55-C.

A. Okay.

Q. What does this exhibit purport to show? What's the purpose of this exhibit?

A. This exhibit is to show that if we had the proposed mechanism in place, the 80/20, what the results would be between Avista Energy and Avista Utilities and how each of those components, where we would -- where the value would come from.

Q. So in terms of the actual modeled result, is that shown in the bottom right section that's the 987 million -- $987,000 --

JUDGE MACE: Is this confidential?

MR. MEYER: No, not that number.

JUDGE MACE: Okay.

Q. Is the $987,315 figure the net result of essentially backcasting in order to arrive at an annual average for Avista Energy were the proposed mechanism in place?

A. That is correct.

MR. TROTTER: Your Honor, I'm going to -- I guess it may be too late to object, but this exact question was asked and answered through Mr. Gruber, and we're now asking this witness to sponsor a Gruber exhibit. So I'm going to object in the interest of economy.

JUDGE MACE: We already have had an answer. I ask you to avoid duplicating, if possible.

Q. Thank you. There was a question on cross now on basin optimization. Look at the same Exhibit 55-C, please. Is there a line -- second line, first and second lines on the top that deal with basin optimization?

A. Yes.

Q. Okay. And do those figures, and I won't read them at this point, because this is already in the record, but that reflects, under the proposed mechanism, the extent of benefits derived by Avista Energy in performing those functions; correct?

A. Yes.

Q. All right. Now, would you turn to Bench Request Number 1? You'd been asked -- you had been asked by, I believe it was Staff, about basin optimization results achieved in -- I believe it was the year 2002. Do you recall that exchange?

A. Yes, I do.

Q. And do you recall the figure that you used?

A. No, I don't.

Q. It was approximately $4 million?

A. Okay, yes.

Q. Okay. Now, that was for that one element for that one year; correct?

A. That's correct.

Q. But when you look at the results of all the elements combined for Avista Energy, as we look back in time, did Avista Energy make money since the inception of this mechanism?

A. No, we have not. And that was the one thing, when we went through all this analysis and spent time, that it was a real eye opener when it came right down to it, when you look at what we started in '99 to where we ended up, and so -- but no, we've lost money. This has not been -- this has not been a good trade for Avista Energy.

Q. Lastly, I believe in your exchange with the Chair, you talked about prospectively going forward what your anticipated or hoped for profits might be, and I believe you mentioned somewhere in the range of one to 1.3 million under the proposed mechanism?

A. That's correct.

Q. And also, I think you mentioned in that exchange that that also took into account the guarantee with respect to transportation capacity release revenues; correct?

A. That is correct.

Q. And you mentioned $3 million?

A. That is correct.

Q. At what level of guarantee do you feel comfortable with respect to the capacity release and off-system sales?

A. Between three and maybe up to four million. But, again, a lot of things have changed out there and I haven't, obviously, been the best predictor of what my risks are out there in the future, but based on, you know, kind of our view of going forward, I think I'd be willing to go to as much as four, but that's with the understanding of going out to the year 2007.

Q. And why do you feel that way?

A. Well, I just think that this year, you know, you may be able to do that, but the future is hard to predict. And if you look at some of the components there, if there's more capacity that comes on, it's just getting harder and harder to capture value on that capacity, and -- because what happens is the market is very responsive to when it sees value like that. So either people will build and -- or figure out other ways to get their gas.

And so my concern is if the guarantee's too high, there's not a lot of incentive out there and there may be some things that occur in the future that are way beyond my control. And I think if you're at three or four, the guarantee, that's a lot of value. And then the way the mechanism is with the 80/20, I get a dollar after we hit that guarantee. And so if, like Mr. Norwood said, if we did six million of the three million guarantee, we're getting about 10 percent. And so I've had a lot of thought on that and -- but I wouldn't be prepared to go anything above four.

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

JUDGE MACE: Mr. Trotter, how much do you have?

MR. TROTTER: Three questions.
JUDGE MACE: Okay.
CHAIRWOMAN SHOWALTER: We're counting.

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

BY MR. TROTTER:
Q. First of all, with regard to the City of Ellensburg, that city is not an affiliate of either Avista Utilities or Avista Energy, is it?
A. No, it is not.
Q. You were asked questions by all three Commissioners regarding the predetermined weighting -- basin weightings, and then you can vary from that to bring in lower cost gas as time goes on. Do you recall those?
A. Mm-hmm.
Q. And you mentioned that in the proposed mechanism, those benefits are shared 80 percent customers, 20 percent AE; correct?
A. That's correct.
Q. But under the current mechanism, the one that's in effect today, 100 percent of those benefits go to AE; correct?
A. That's correct.
Q. And then, finally, I think, you mentioned

that Avista Utilities' transportation capacity was about -- contributed about 20 percent to AE's total capacity. Do you recall that?
A. That's correct.
Q. And that figure does not include storage or LNG capacity, does it?
A. That is needed for the Utility to meet their peak day, so that wouldn't be in there. So I guess the problem I would have is I can't use that transportation, because on a peak day, it's needed elsewhere to serve the load.
Q. And you can't use it on a non-peak day?
A. Some of it, I can't. The TF-2, some of those, I can't, no.
Q. All of it, you can't?
A. No, not all of it, but, again, I can't go out there and do a deal to bring firm supply up if, at a moment, the transportation needs to be used to serve the Utility, I now have a customer that I can't get supply to. So I have a difficult time putting that into my resource stack.
Q. So it's your testimony that at no time has AE used Avista Utilities' Jackson Prairie storage for the LNG storage capacity for non-Utility purposes?
A. We use the Jackson Prairie to serve the

load, and LNG is a peaking resource that's there to serve the load should supply not come up. We have used LNG.

Q. And then, lastly, you said that AE expects to earn between a million and a million-three off the mechanism?

A. That is correct.

Q. And that's inclusive of the $900,000 flat fee?

A. That's correct.

Q. So in addition to the flat fee, you're expecting to make to 200 to $400,000 additional?

A. That's correct.

Q. Are you willing to have that capped in any mechanism approved by this Commission to that level?

A. No, I'm not.

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

JUDGE MACE: Mr. Cromwell.

MR. CROMWELL: Nothing further, Your Honor. Thank you.

JUDGE MACE: Thank you. You're excused.

THE WITNESS: Thank you.

JUDGE MACE: We'll take a 15-minute recess.

(Recess taken.)

Whereupon,

CATHERINE ELDER,

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. Cromwell.

MR. CROMWELL: Thank you, Your Honor.

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

BY MR. CROMWELL:

Q. Ms. Elder, please state your name and business address for the record.

A. Catherine Elder, address is 20310 -- I'm sorry, 2710 Gateway Oaks Drive, Suite 300, in Sacramento, California.

Q. And you filed testimony with accompanying exhibits in this case; is that correct?

A. That's correct.

Q. And those were previously admitted as Exhibits 251-C, 252, 253-C 254-C, 255, 256, 257-C, 258-C, and 259. Do you have those in front of you?

A. I do.

Q. And are you also aware that on September 18th, at the prehearing conference, we made certain errata corrections, and are those reflected in the

copies of the testimony you have before you?
A. They are.
Q. With those errata corrections, are there any other corrections you need to make, or are those exhibits true and correct, to the best of your knowledge?
A. They are.
Q. And were I to ask you the same questions posed in that testimony today, would your answers be the same?
A. Yes, they would be.
MR. CROMWELL: Your Honor, Ms. Elder is now available for questioning.
JUDGE MACE: Mr. Meyer.
MR. MEYER: Thank you.

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

BY MR. MEYER:
Q. Good afternoon, Ms. Elder.
A. Good afternoon.
Q. In looking at your testimony, I believe I have this right, but you stated you worked at Pacific Gas and Electric from 1985 to 1991?
A. That would be correct, yes.
Q. While you were there, did you personally

purchase or sell gas on a day-to-day basis?
A. If what you mean by that is as a trader, no, I was not a trader. I was in the gas purchase group that developed policy, including PG&E's gas purchase policy, that opined on implementing that policy. I was part of the natural gas -- the monthly spot gas group that opined on and implemented that policy, those sorts of things.
Q. But you did not -- you were not immediately and directly involved in the day-to-day purchasing function, were you?
A. Not insofar as implementation on a day-to-day basis, no.
Q. Okay. Now, likewise, have you personally and directly involved yourself with the release of pipeline capacity on a day-to-day or short-term basis?
A. Not in a trading context, no.
Q. Okay. Now, have you otherwise directly been engaged in arranging for the transportation of gas in a segmented -- strike that.
Have you participated directly in segmented capacity releases?
A. Have I arranged for capacity segmented contracts or have I arranged to release capacity on a

segmented basis, no, I have not arranged to release capacity.

Q. Okay. I believe you mentioned in your testimony that there are three basins from which gas is procured under this benchmark mechanism. Would you agree?

A. Generally, yes.

Q. What are those three basins?

A. We would generally refer to them as Rockies, or Rocky Mountain supply, the Alberta basin, part of the Western Canadian sedimentary basin, and the third ostensibly would be British Columbia Gas, which sometimes we separate out from the WCSB and sometimes don't.

JUDGE MACE: You're going to have to slow down a little bit. What's WCSB?

THE WITNESS: Western Canadian Sedimentary Basin.

JUDGE MACE: Thank you.

Q. Now, which -- of course, you're aware of the pipelines from which capacity is contracted for on behalf of Avista, don't you?

A. Yes.

Q. And those two are?

A. Those would be Northwest Pipeline and

Pacific -- what I call Pacific Gas Transmission.

Q. Sure.

A. Today I believe known by a revised name, given the PGE bankruptcy and given the NEG bankruptcy, it's now NEGT.

Q. Okay. And of course, I assume you are familiar with any bottlenecks on the pipelines in terms of flows?

A. Generally. I might not know of a specific bottleneck existing on a specific day, but, for example, if you want to talk about constraints on the Columbia Gorge, I'm certainly generally knowledgeable that those constraints exist and that Northwest Pipeline has just implemented a pipeline expansion to correct those kinds of restraints and reduce the reliance on displacement capacity and calling OFOs for customers in the Gorge.

JUDGE MACE: I'm sorry, what's --

THE WITNESS: OFOs.

JUDGE MACE: And what are those?

THE WITNESS: Operational flow orders.

JUDGE MACE: Thank you.

Q. Are you aware of the extent to which there is excess pipeline capacity available in the Northwest?

A. In the general sense that there is excess capacity, yes.
Q. Do you have any sense of the magnitude of that excess capacity?
A. Ironically enough, I've calculated it within the last week for a client report, but I don't have the number in mind.
Q. So when you prepared your testimony in this proceeding, that was several weeks ago; correct?
A. It -- we filed the testimony in July, so several months.
Q. And at that time, did you have in mind a number or an order of magnitude with respect to excess pipeline capacity?
A. I'm not sure I needed to do that, no.
Q. Okay. Still on the subject of capacity releases, you're suggesting, if I read your testimony correctly, that Avista Energy should be able to achieve approximately $10 million annually in capacity release revenues; correct?
A. We put that calculation in the testimony, yes.
Q. Okay. Now, you make several assumptions in getting to that number, don't you?
A. Yes.

MR. CROMWELL: Excuse me, Your Honor. Does Mr. Meyer have a citation to the testimony that we could all refer to?

MR. MEYER: Yes, if you need to, it's her 251-T, page 13, lines three through five. Don't know that you need that for purposes of this, but you're --

MR. CROMWELL: Thank you.

MR. MEYER: -- you're welcome to. Okay.

Q. Okay. Among the assumptions that you made in arriving at that figure was that the -- you used the average Tier 1 and Tier 2 loads per day, based on the combined Washington and Idaho jurisdictions, didn't you?

A. I'm sorry, what page and line?

Q. Well, my reference here is to your Exhibit 251-T, page 13, lines three through five.

A. I'm not seeing a reference to the Tier 1 and Tier 2 there.

Q. I'm sorry. My reference was to the 10 million at that -- did you, among your assumptions, did you use the average Tier 1 and Tier 2 loads per day for the combined Washington and Idaho jurisdictions?

A. I used the number, the load numbers from Mr.

Gruber's exhibit.

Q. Did that include both Washington and Idaho, or do you know?

A. I do not know off -- at this moment.

Q. Okay. Secondly, did you -- did you assume that the difference between the average load for each month and the total capacity for each of the transportation contracts would be otherwise available for release?

A. Would you say that again for me?

Q. Sure. Did you assume that the difference between the average load for each month and the total capacity for each of the transportation capacity contracts, that that difference would be otherwise available for release?

A. Yes, I think that is essentially correct, and we made some allowances for the difference between the average load and ostensibly a peak load, but as a ballpark figure, that was the basis.

Q. Haven't you therefore assumed that -- assumed the release of capacity that is otherwise necessary to cover load swings over and above the average load?

A. Well, I think that with a caveat that I just gave you that we made some allowance around that to capture the peak load above that average, that my answer to you would be, no, I did not.

Q. Okay. And where have you otherwise addressed that or adjusted that assumption?

A. At line 17, on page 12, I mentioned, using the monthly load profile shown at page three in Exhibit RGH-2, I added an additional 10 percent reserve margin.

Q. So is it your testimony that that reserve margin somehow captures the difference between average load and peak day load?

A. In a general sense, that's what it's intended to do.

Q. Would it be prudent for a utility to retain enough capacity to meet peak load conditions?

A. It depends.

Q. When would it not be?

A. When would it not be prudent to hold enough capacity peak demand?

Q. Yes.

A. If you were in a market where you had a very strong sense that there were alternative suppliers that you could access via a call option, or if you had storage near your load center, which was under your sole control, it might very well be the case that you would choose to not hold capacity to meet your -- interstate pipeline capacity to meet your peak day demand.

Q. Do either of those two assumptions ring true with respect to Avista Utilities, do you know?

A. I don't know for certain.

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

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Just so that I'm clear, the witness' last answer, or the -- just previous, the more extended answer was an answer to when would it be prudent not to reserve peak -- it was a funny construction of the question and answer. It sounded as if you were saying when would it not be prudent not to have peak. Was your answer when -- did your answer address the question when might it be prudent not to reserve for your peak?

A. I think so. I think that's the question Mr. Meyer asked me.

MR. MEYER: Yes, it is, thank you.

THE WITNESS: And I think that's the question I managed to answer.

CHAIRWOMAN SHOWALTER: I think you did, too.

Thanks.

JUDGE MACE: Okay. I don't show any other cross-examination for Ms. Elder, so the Commissioners, if they have questions, this is the opportunity.

CHAIRWOMAN SHOWALTER: I have one question.

Q. And it's surrounding the issue of the 69 cents per million Btus versus -- I don't know what the other figure is. Let's see.

MR. MEYER: I think it was 27.

Q. Twenty-seven cents. And I'm sure you've read the rebuttal testimony of the company and heard some discussion of it today with Mr. Gruber. And I want to know whether you still think that -- first, is 69 cents accurate? Is that your calculation?

A. Sixty-nine cents was not my calculation. My calculation was shown at page 12, line 14 of my testimony.

Q. Let's turn to that. I'm not turned to it right now. So that's 251, page 12?

A. Correct.

JUDGE MACE: It's a confidential page; is that right?

THE WITNESS: It is a confidential page, yes.

Q. I take it -- okay. Page 12, line --

A. Fourteen.

Q. Fourteen. Okay. Now, so you derived the cents per MMBtu on line 14 from the figures in the previous lines; is that correct?

A. Correct.

Q. And just so somebody can clue me in, you're working off of DR-57. What exhibit number is that, if someone knows?

JUDGE MACE: That would be Exhibit 11. Staff DR-57 should be Exhibit 11, Mr. Norwood's exhibit.

Q. So maybe we -- all right. Well, knowing now what the source of your calculation is, do you stand by the confidential number in your testimony at page 12 as a correct assumption for Avista Energy and/or Utility to benefit from the basin supply optimization?

A. The 72 cents represents --

Q. Well, it says that's confidential.

MR. MEYER: It's fine.

THE WITNESS: And I just said it, didn't I?

MR. MEYER: That's fine.

Q. All right. We're not worried about that number. So you're saying it's 72 cents, which of course is even higher than 69 cents?

A. It is. What that number represents is that average effective cost of the pipeline transportation that Avista holds.

Q. Cost?

A. Cost. Average effective cost. So in other words, it takes the pipeline demand charges and divides it by the total amount of capacity that Avista holds.

Q. All right. Well, I'm vaguely following you, but now, if you're going to derive a potential benefit of basin optimization, why -- did you, and if so, why would you use this cost?

A. What would be better to use would be to use the actual cost that -- of Avista's transportation capacity. So in other words, I calculated the average effective cost at basically their load factor. So in other words, if you took the capacity that they hold and you look at how their actual throughput compared to that, it's pretty expensive relative to the actual cost, actual tariffed cost of the transportation.

If I substitute a number that's -- that is closer to the actual tariffed cost, indeed you would see the number that's in exhibit -- I'm going to space on the exhibit number -- 254, where we calculated the 13 kind of number.

Q. Well, the reason I'm confused about all of this is that I -- in the earlier discussion, I didn't think we were talking about cost. I thought we were talking about constraints in a tariff on what could be charged.

A. You're correct. You're not confused. The tariff constrains the price that can be charged in the open market to cost.

Q. To cost or to a number?

A. To a number that's cost.

Q. Well, in any event, when one is trying to calculate potential benefits from basin optimization, doesn't one need to bear in mind constraints, if any, including regulatory constraints, on what I would have said one can charge?

A. I will agree with you.

Q. All right. And if that's the case, do you agree with Mr. Gruber that, for sales that are not off-system, I think is the term, that constraint is 27 cents?

A. I'd have to look up at the tariff, but I will accept, subject to check, that the tariffed rate's 28, 27 cents.

Q. All right. And then there are some off-system sales that are not subject to that constraint?

A. That's correct.

Q. And do you agree that you would want to calculate some kind of projection about off-system sales and, I forgot the term, on-system sales.

JUDGE MACE: Capacity release.

Q. Capacity release, thank you. In order to project the kinds of benefits you might make from basin optimization?

A. Yes, I think I agree.

Q. All right. Now, did you make a projection of basin optimization benefits?

A. No, I did not.

Q. Well, then, what is Exhibit 254-C? Let's see.

A. 254-C was a calculation of potential capacity release revenues.

Q. That you made?

A. That's correct.

Q. Well, is this the kind of calculation one -- strike that question.

In your mind, what's the purpose of this exhibit and your calculations here? What does it demonstrate?

A. The purpose was to try to explore whether or not $3 million was roughly in the ballpark of what Avista should expect to obtain in terms of capacity release revenues in the market.

Q. And what does it show -- bear in mind this is confidential, so I'm not sure -- you could point to me what figure instead of three million is the appropriate one, if this calculation shows that?

A. Well, the calculation shows a number that begins with one-three.

Q. In the bottom right-hand corner?

A. Correct, in the bottom right-hand corner there.

Q. All right. But doesn't that number assume or use a 69-cent figure instead of a combination 27 cents, no limit, weighted by capacity release and off-system supply?

A. It uses the 72 kind of number.

Q. All right. Now, if the 72 kind of number is not accurately reflective of potential benefits, why are you using it here, or at least why are you purporting to have this document demonstrate that the potential value's really much greater, much greater than three million?

A. We focused, in preparing the testimony on the average effective cost of the transportation and not the tariffed rate.

Q. Okay. So is another way to put all this is that focusing on the effective rate is not a very good indicator or basis upon which to project potential benefits from optimization?

A. I think I'll agree with that.

CHAIRWOMAN SHOWALTER: Okay. Thank you. I think that's all I have for now. Thanks. I might have had another one, but --

COMMISSIONER HEMSTAD: I don't have any questions.

COMMISSIONER OSHIE: No questions.

CHAIRWOMAN SHOWALTER: You know what, I do have one more question.

Q. I believe it's -- there's discussion in your testimony, as well as Mr. Parvinen's, about the importance of being able to trace actual costs or to make sure that cost advantages are, in fact, passed on to Avista Utilities. And I'm sorry, I can't point at this moment to your testimony, but my most general question is when one is dealing with a contract or a hedge or an incentive, is it, by definition, one is moving off of the lower of market or cost and moving onto something different, which is an incentive mechanism or hedge, which poses some kind of screen from seeing actual cost, and isn't that really the purpose -- not the purpose of it, but a necessary effect of hedges and benchmarks and incentives? Maybe not benchmarks, but hedges and incentives.

And the policy issue is is the benchmark and incentive ultimately going to be more effective than something that is more trackable, meaning lowest of market or cost?

A. I agree with what you said about the hedge and incentive and separating out benchmark in that I think that you're -- it's true that you can think of a hedge as a restatement of cost. In other words, it takes -- you know that you're going to face a cost on a variable basis at first of month index, let's say, so the cost will change every month. Whatever that cost is will be whatever the market sets it at and you'll face that every month.

What you do in one type of hedge would be to swap that variable cost for a certain cost, and it's not probably correct to say that one wasn't your cost or the other was your cost; simply that you transformed the cost from one type of way to incur it to a different type of way to incur it.

Q. Right. So for example, if Avista Utilities takes this function in-house, it might well execute a fixed price contract or a hedge or a financial hedge, right, in which case that would be its cost, but we would not know what the person on the other side of the contract or financial hedge did to deliver?

A. I think that's also correct, yes.

Q. So now we're talking about, aren't we, just a similar contract, or you can call it a hedge, between Avista Utilities and Avista Energy, am I right so far?

A. Yeah, that sounds -- seems like a reasonable way to think of it, in some respects.

Q. So the element that's interjected here is the fact that the party on the other side is an affiliate?

A. True.

Q. And -- or may be an affiliate, depending on how you read a statute. So I get to the issue not that -- it's a given that a hedge or an incentive mechanism is probably not going to be able to track actual costs or at least a guarantee of the lower market or cost; otherwise we wouldn't have a hedge?

A. That's true.

Q. So don't we need to decide whether a hedge or a incentive mechanism is appropriate if it's undertaken with an affiliate?

A. Yes, I think you do need to decide that.

Q. All right.

A. And I think what both Mr. Parvinen and I were getting at in that part of our testimony that went to those questions was what you'd like, I think, or what ratepayers would like, if we could talk to them all as a group, would be to know that the price that they pay in their rates for natural gas somehow reflects the cost of the gas, that they're paying a reasonable price for that gas.

Q. Well, you have a statement here that you think that a guarantee ought to be 10 million. I'm assuming that that's an Idaho and Washington figure. I don't know if it is or isn't, but do you think that that is a reasonable -- actually a reasonable amount for Avista Utilities to pay Avista Energy? No, excuse me, the reverse, that the deal should be struck differently and Avista Energy should guarantee Avista Utilities $10 million, whether or not that's Washington or Washington/Idaho?

A. Well, 10 in this context would seem a little excessive. That was in the context of trying to look at capacity release revenues. Whether -- if you're asking the question should -- what should Avista Energy pay to Avista Utilities in exchange for the privilege of -- privilege, in quotes, of managing its procurement activity or undertaking all these tasks on behalf of the Utility, I don't think that there's actually anything in my testimony that would give you a total ballpark figure for doing the job, if you will.

Q. Okay. And I apologize for misreading that earlier figure. Thank you.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. I would like to pursue one point. And in a certain sense, this is the ultimate question, it seems to me. In what you address in your testimony, and that is are the -- are Avista's utilities customers getting a good deal here or not, and you say they are not, and then there are references to your Exhibit 256. And I'm -- I would appreciate it if you could walk me through that exhibit so that I understand what it's saying.

A. Sure. 256 tries to do a very high-level view, big picture view of let's take Avista's cost of gas and compare it to what it would look like if they had just bought gas at the basin weighting percentages from the three basins. So if they bought gas from the Rockies, gas out of Alberta, gas out of British Columbia, at the basin weighting percentages that are in one of Mr. Gruber's exhibits, which I will never identify for you correctly, --

Q. But they're the percentages we've been using here consistently?

A. Exactly, exactly. And we just calculated with first of month index prices from those basins times those basin weighting percentages what the cost of gas would have been. And we simply then compared that to Avista's actual cost of gas. Avista's actual cost of gas came to us from an answer to a data request. It's in the column that's labeled Avista commodity PC-9 answer. And so if you read all the way down the page from over the period September 1999 to April 2003, that was all the data that we had available to us, Avista's average cost of gas would have turned out to be $3.97 cents, whereas if we had taken the first of month index prices times the percentages, we would come up with a cost of gas that was 75 cents per MMBtu higher. And I'm sorry. I just said higher. I should have said lower. It would have been 75 cents lower.

So it would appear, just on a very straightforward, first of month index basis, that the total average cost of gas to consumers was 75 cents higher than had Avista just bought at the basin weighting percentages. Now, granted, they've got some hedging activity involved. They didn't buy all of their gas at these percentages. But this exhibit just simply tried to take a big picture view and say, Well, what if. What can we take their result and compare it to and try to make some sense of it.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. But isn't that the classic hindsight? I mean, there would always be something you could derive that would do better than what actually happened. I mean, we are presented with this frequently. A company starts out on some kind of plan and there really is quite a range of what might be reasonable, and then it plays out, and virtually always there is some other arrangement that some other company actually did that turned out better, so some gas companies buy a whole lot in advance, others go month-to-month. History plays that out in different ways. So we don't know whether Avista

Utilities would have done exactly this or would have they done something very similar to what Avista Utilities did and maybe even lost more or maybe less.

A. Sure. No, and this was not intended to be hindsight analysis, a hindsight analysis that says, Oh, you should have bought all of the gas at that first of month index, not at all. The point was more to try to give you, Commissioners, an example of -- you know, at the end of the day, you've got to feel comfortable that what you asked ratepayers to pay was reasonable. Does the benchmark result in something that you can look ratepayers straight in the face about.

And so if you asked the question, Well, what -- if they had done first of month index strategy, what would that have looked like, and how does what they actually achieved compare to that. So I want to give you some sense of a comparison.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. Well, I suppose the inference we are to draw from this is if the company simply mechanistically bought based upon the first of month index prices in those percentages, it would turn out better --

substantially or measurably better off, and you would draw from that that sort of the expertise of Avista Energy wasn't worth it?

A. Well, this formulation of just simply taking the basin weighting percentages and buying at first of month index really wouldn't necessarily use any -- any special knowledge or activity by Avista Energy. Avista Utilities could implement this.

Now, the other thing that I didn't tell you or didn't say in calculating this number for you was tell you whether 75 cents per MMBtu was -- you could think of that differential as a premium paid for price stability. And I did not comment to you as to whether I thought that was too high a premium to pay for price stability, but that's one way of looking at this difference, and that's one way that you can look at the results that either Avista Energy or Avista Utilities would get for you.

Q. Well, I'll ask the question. What is your view as to whether price stability is worth that price?

A. Seventy-five cents seems like a lot. On -- I probably will think of it this way. On an average cost of gas that came out to be roughly $4 per MMBtu, 75 cents is close to 25 percent of that.

Now, to be fair, if you think about the fact that this covers the period during the price spike, you can see, if you look at November '00 and December '00, prices being in the 13 and $14 per MMBtu range for those two months on a first of month index basis at Sumas. Those are extraordinary prices. You have a lot of prices in the six and $8 range, as well. In that context, 75 cents may not be so bad, but it's a lot -- from my personal perspective it's a lot to swallow.

COMMISSIONER HEMSTAD: Okay. Thank you, that's all I have.

JUDGE MACE: All right. Mr. Cromwell, redirect?

MR. CROMWELL: Thank you, Your Honor.

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

BY MR. CROMWELL:

Q. Ms. Elder, Commissioner Hemstad asked you sort of his bottom line question of whether you thought it was a good deal or not, I think was his language. What is your primary recommendation to the Commission in this proceeding?

A. We recommended that the mechanism not be adopted.

Q. Mr. Meyer asked you a number of questions regarding your experience back at PG&E in California. Do you recall those?

A. Generally.

Q. And regarding the purchase and sale of gas, pipeline capacity, segmented capacity release, is it correct that you directed the activities of individuals who did perform those functions?

A. No, I probably wouldn't say that, either, although it is true that more recently one of my assignments involved the California Department of Water Resources as a result of certain actions undertaken by the state of California during -- after the power crisis, helping those folks get their gas purchase operation up and running. But my involvement in those activities at PG&E were much more in the nature of being a member of the spot gas working group and analyst who helped coordinate regulatory issues with the day-to-day operational issues.

When we got into things in 1989 and '90 and '91 in terms of doing capacity release on PGT, I actually developed the program under which Pacific Gas and Electric released its capacity on PGT and got FERC to approve it prior to Order 636 being issued.

So I've had a lot of involvement in those kinds of operational things, but did not actually do trading, as it were.

Q. You also used the term OFO. Would you just please define that phrase?

A. Operational flow order. And I like to think of it as parties are playing musical chairs and the music stops, and an OFO is a pipeline saying, I'm going to stop the music and you better get in line now or sit on your chair now. And by sit on your chair, what they mean is that you need to bring your usage into exact balance, and sometimes there's a tolerance band around that, but in essence, into exact balance with how much gas you're putting into the pipeline.

Q. And what is the purpose of a pipeline manager issuing an OFO?

A. A pipeline manager could have to issue an OFO when parties are taking more gas out of the pipeline -- collectively, parties are taking more gas out of the pipeline than they're putting in.

Q. And you also had some discussion with the Commissioners regarding auditability of a benchmark mechanism. Is it true that you -- Avista could propose a benchmark that would be more auditable than the benchmark mechanism that is proposed here?

A. I certainly thought so, yes.

MR. CROMWELL: I have nothing further, Your Honor.

JUDGE MACE: Anything else, Mr. Meyer?

MR. MEYER: Just a few follow-ons, please.

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

BY MR. MEYER:

Q. Just to be clear about this, are you recommending that a utility or, in fact, this utility, buy all of its gas at first of month indexes?

A. No, I'm not recommending that.

Q. Because if one were to do that, if the Utility were to do that, would that subject the Utility and its customers to fairly substantial price volatility?

A. I agree that it would subject them to volatility, and part of the Utility's job should be to manage that volatility.

Q. And isn't it true that, over time, with hedging, there will be occasions when the hedging activity will provide lower costs than a first of month purchasing?

A. We hope so.

MR. MEYER: That's all. Thank you.

JUDGE MACE: All right. Thank you. You're excused.

Whereupon,

MICHAEL P. PARVINEN,

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

JUDGE MACE: All right. Please be seated.

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

BY MR. TROTTER:

Q. Mr. Parvinen, would you please state your name and your position?

A. Michael P. Parvinen, I'm a regulatory analyst.

Q. And who is your employer?

A. Washington Utilities and Transportation Commission.

Q. And in the course of your employment with the Commission, did you prepare testimony and exhibits in this case?

A. Yes.

Q. And am I correct that the following exhibits were prepared by you or are documents prepared by others that you're relying on: Exhibit 201-T is your direct testimony, and then you're also sponsoring Exhibits 202 through 208, 209-C, and 210 through 212; is that right?

A. Yes.

MR. TROTTER: Your Honor, because those exhibits have been admitted, Mr. Parvinen is available for cross.

JUDGE MACE: Mr. Meyer.

MR. MEYER: Thank you.

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

BY MR. MEYER:

Q. Good afternoon.

A. Good afternoon.

Q. Let's turn first to the subject of basin weightings. Doesn't Staff suggest in its testimony that there should be more flexibility in setting the supply basin percentage weightings, essentially doing so more frequently than once a year, as is now the practice?

A. Yes, that's right. In my testimony I propose twice a year.

Q. Isn't it true that once the basin weighting percentages are established for the upcoming year, that this serves to provide a guide for the amount of excess pipeline capacity that is available from each supply basin?

A. Yes, it does.

Q. Doesn't this allow the company to plan for longer term pipeline releases and off-system sales?

A. Yes.

Q. Doesn't pipeline transportation flexibility also need to be reserved for the use of Jackson Prairie storage transactions in order to provide service under a variety of load conditions?

A. Yes.

Q. If Avista were to implement changes in basin weightings, as recommended by Staff, that is to say do it say twice a year, wouldn't the longer term non-recallable capacity releases need to be modified to allow for greater flexibility, given the change in basin weightings?

A. No, I don't believe they would. We would only be -- what I was referring to in changing the weightings would be the difference between, for example, the Rockies, it has a variable of somewhere between 18 and 25 percent. Those constraints already take into consideration those longer term capacity releases.

If the company were to do other long-term capacity releases that would affect those parameters, as I've stated also in my testimony, that those could be built into those basin weightings when they were changed.

Q. Is it your position that near and let's say mid-range to longer term capacity releases would not be disturbed if one were to change the basin weightings in the middle of the year?

A. I think I missed your question. Were you saying that is it my testimony that those would not change, or am I recommending?

Q. That if one were to adopt your recommendation to change basin weightings twice a year, wouldn't a company have to essentially recall, if you will, some of its longer term capacity releases to match up with the revised basin weightings?

A. No, those would already be in place and they would be reflected in what the proposed weightings going forward would be.

Q. So you see no connection between revising basin weightings and the extent to which the company can enter into longer term capacity releases?

A. I think they go hand in hand and can be reflected upon each other.

Q. Are longer term capacity releases generally worth more than short term or near term capacity releases, or do you know?

A. I guess, in general, I would say that longer term releases would have more value.

Q. In terms of the quantification of customer benefits as a result of this mechanism, you understand that the company has made the case for annual benefits that approximate 2.6 million a year?

A. Yes.

Q. Okay. Now, Staff, on the other hand, argues that customers would, in fact, benefit in the amount of a million-six were the procurement functions returned to the Utility. Do I have that right?

A. That's correct.

Q. And can we agree that far and away the two largest differences between Staff and the company in that regard have to do with essentially two areas? One is load volatility and the second has to do with transportation benefits?

A. Yes.

Q. Okay. With regard to load volume volatility, is it your judgment, Mr. Parvinen, that the cost to serve daily load volatility is zero?

A. Yes, that's what I projected in my analysis.

Q. Okay. Is that judgment -- is that judgment supported by any specific calculations?

A. Yes.

Q. Okay. I'm sorry, are you finished?

MR. TROTTER: He was about to complete his answer.

THE WITNESS: I was going to expand on where those are demonstrated. One of the things I said in my testimony was that, on any given day, the company has the ability to inject or withdraw from storage to meet those daily needs. And also in my testimony, I said that there were times when that would not be possible and -- but on those times when it would not be possible, that there were offsetting factors.

Q. Okay. Now, in fact, don't you assume, in your words, that these, quote, unquote, positive situations can offset the times when physical constraints create actual costs beyond the first of month index?

A. Yes.

Q. Okay. Do you have before you a copy of what has been admitted as Exhibit 56, and that is your response to Avista's Data Request Number 1?

A. Yes, I have that.

Q. Okay. Turning to page one of two of that, your first paragraph, first two paragraphs read, Mr. Parvinen's testimony -- and this is your response -- addresses that part of Avista's analysis that assumes all volatility is purchased and sold at the gas daily index creating a net cost as compared to the FOM index. Mr. Parvinen challenges Avista's assumption because, in his judgment, there are situations in which a net benefit occurs that can offset those situations when a net cost occurs. To form his judgment, Mr. Parvinen made no specific calculation to measure the positive situations described in his testimony. It would be very difficult to perform such a calculation, because there are many variables that could affect the decision-making process.

And then, granted, you go on to offer a further explanation. Have I at least read that much of it correctly?

A. Yes.

Q. Okay. Simply put, haven't you, through the exercise of your judgment, without the benefit of a specific calculation, simply zeroed out or assumed away the cost to cover Tier 3 load volatility?

A. Well, I made -- I did make the assumption that those offsetting benefits would offset the cost. Upon receiving the company's rebuttal testimony, I did -- well, the company's rebuttal testimony provided what those offsetting benefit numbers could be, and likewise, I also looked at one of the particular months. In my testimony, I gave an example of October as a month when storage was full going into October, so that if loads were less than average, there would be excess volumes and you would not be able to put those into storage, so you may be forced to sell those into the market. That may produce a cost.

So I happened to look at October of 2002, and indeed that was a month that started off with loads being less than average, so the company would have, under this mechanism, sell into the market, and I followed October through to see what would happen. It ended up producing a cost of about $8,500.

Q. So you picked a month to do that analysis with?

A. Yes, in my testimony, I described a shoulder -- shoulder month as being examples, October on one end and I believe April on the other end, when storage would be empty, so you would not be able to pull storage since it would already be empty.

Q. Now, you refer to the rebuttal testimony of the company presented by Mr. D'Arienzo, that provided an analysis in the form of four possible scenarios for the period September 1999 through February 2003; correct?

A. Yes.

Q. Does that analysis -- do those calculations purport to demonstrate that the positive occurrences do not, in fact, offset the negative occurrences as you assumed in the process of applying your judgment?

A. No, I'd actually say just the opposite. When I looked at those four analyses -- let me pull open Mr. D'Arienzo's testimony and get to that page.

JUDGE MACE: Do you have that page in front of you, Mr. Meyer?

MR. MEYER: Yeah.

JUDGE MACE: What page is that?

MR. MEYER: It's his Exhibit 102-T, page nine, lines 21 through 23, or thereabouts. Certainly I think it's page nine, in any event.

MR. TROTTER: Go ahead and complete your answer, Mr. Parvinen.

THE WITNESS: As I described in my testimony, scenario one would be a cost that would be avoided by sticking the gas into storage, rather than selling it at a price less than the first of the month. Likewise, scenario four would be a cost that would be avoided because you could pull the gas from storage and avoid buying the gas at a price increase.

Scenarios two and three would be examples of those offsetting factors that I described, which, in this case, would be a positive value of about $2 million. This is over that roughly three and a half-year period.

Q. Do you understand that the negative numbers in the table reflect a benefit to the Utility as a result of Avista Energy providing this service?

A. I guess I was thinking in terms of the Utility, if it had the mechanism. The Tier 3 costs would be a cost that the Utility would be picking up, and my testimony is it would be avoiding it, so I guess these numbers would be just the opposite.

Q. Well, isn't that column clearly entitled (benefit), and the numbers reflected below that column, page nine, line 19, to the extent they're in parentheses, reflect benefits, not costs?

A. Well, this chart is to show the benefits provided by Avista Energy to Avista Utilities, so if the mechanism were to revert back to the Utility, these would be just the opposite. The $8 million would be a cost to the Utility, so that those negative numbers would be cost to the Utility if it were providing them, providing them.

Q. Or conversely, to the extent that Avista Energy is providing these services, there's a benefit; correct?

A. Well, that's what these numbers represent, yeah.

Q. Okay, thank you. Turning to the second area in which -- about which there is apparently major disagreement or it's a disagreement about a major element, the cost benefit analysis, that has to do with the estimated level of transportation benefits?

A. Yes.

Q. Haven't you reduced the estimated loss of transmission benefits from two million to zero?

A. Yes.

Q. Don't you essentially argue that the actual levels of capacity releases and off-system sales revenues are not representative?

A. They're representative of what the Utility would be able to achieve going forward, yes, I think.

Q. I'm sorry?

A. Why don't you repeat that question, because I thought I had the answer and then I confused myself.

CHAIRWOMAN SHOWALTER: And before you repeat it, I know what chart you're talking about, but can you get me on the page?

MR. MEYER: Sure. Actually, probably the best thing is there's a side-by-side chart in Mr. Gruber's rebuttal. I think it's page three of his rebuttal.

CHAIRWOMAN SHOWALTER: That's Exhibit --

JUDGE MACE: Fifty-three.

MR. MEYER: Fifty-three.

CHAIRWOMAN SHOWALTER: Yes.

MR. MEYER: Just make sure everybody's --

Q. And again, just so we're clear about this, on that Exhibit 53, we had previously talked about load volatility. Now we're talking about the line entitled estimated loss of transportation benefits. As you can see from the side-by-side, there's a discrepancy of $2 million. Are you essentially arguing that -- and I'll repeat the question, so we make sure you have it in mind. Are you essentially arguing that the actual levels of capacity releases and off-system sales revenues are not representative because they cover a two-month period during the so-called energy crisis in which you contend Avista

Energy was able to capture approximately 10 million of net benefits?

A. Yes.

Q. And do you go on to characterize this as a -- as an anomaly that you believe should be excluded from the evaluation of what the Utility could achieve as compared with what Avista Energy could achieve?

A. Yes.

Q. Now, you reduce the benefits in your analysis that Avista Energy actually achieved during this anomaly period, didn't you?

A. That's correct.

Q. Did you also reduce the level of benefits that the Utility itself would have achieved during the same so-called anomaly period?

A. I did not. The reason for that was when I looked at the revenue in those two months for Avista Energy, it was clearly, like I testified to, an anomaly period, where those two numbers were five and a half million and six million. During the rest of the period, the highest other month was approximately 900,000. So I mean, those were clearly, far and away, an anomaly. When I looked at the revenues that it was estimated that the Utility would be able to provide, that same anomaly did not seem to exist, so

I did not normalize those for purposes of the calculation.

I did take a conservative approach in that my Exhibit 209-C, in the middle group on line 21, that actually showed a negative number.

MR. TROTTER: Can we just pause so we can get to it?

THE WITNESS: Sure.

MR. TROTTER: Which line again? And continue, please?

THE WITNESS: Line 21 actually showed a negative number. I did not carry that negative number over to that calculation in the chart. I left it at zero, not at negative. So I was being conservative to allow for that possibility, and I mentioned that in my testimony.

Q. Well, to be -- to be fair about it, wouldn't it be more appropriate, if you're going to normalize one side of the equation, so to speak, to normalize the other? And if you're going to pull out 10 million on one side as anomalous, why wouldn't you pull it out on the other side, if the Utility had been operating this mechanism?

A. I looked at those months, and it did not appear that the anomaly existed. I have, since then, gone through and said, Okay, well, fine. If we normalize that period, what does this number come out to. And the negative number on line 21 does become slightly positive. It was -- would become 230,000, which I would put on line six on that number, so if you were to normalize both sides, I came up with a number that was 230,000 instead of at zero.

MR. TROTTER: Your Honor, just for clarification, line six was on what exhibit that you would move that figure to?

THE WITNESS: It would be my Exhibit 208 or --

JUDGE MACE: That would be what would appear --

THE WITNESS: Yeah.

JUDGE MACE: -- for estimated loss of transportation benefits in your table?

CHAIRWOMAN SHOWALTER: In Exhibit 53, page three.

MR. TROTTER: Right.

JUDGE MACE: Right.

MR. TROTTER: And his side of that is 208. So either place. Thanks.

CHAIRWOMAN SHOWALTER: On line 19.

JUDGE MACE: Yes.

MR. TROTTER: Yes, just for clarification, it would be on line 19 in Exhibit 53-T, page three, but it's on line six of your Exhibit 208; is that right?

THE WITNESS: Yes.

MR. TROTTER: Thank you for allowing me to clarify.

Q. Among the alternatives you recommend, is the need for a competitive bid essentially putting this mechanism out to bid for other third parties; is that correct?

A. Well, it was leaving the option up to the company to either discontinue the mechanism or put it out for bid.

Q. Would you agree that Avista Energy has invested considerable time and effort over the past several years to fully understand the nuances involved in serving the utility under this mechanism?

A. Yes.

Q. And in the process, hasn't it developed an important base of knowledge specific to this Utility?

A. Yes.

Q. Wouldn't it take at least as much time for a third party new to the scene otherwise unfamiliar with Avista's load requirements to get up to speed?

A. Well, I would guess -- I would say that the RFP, the request for proposal, would put out parameters to fairly display to potential bidders what would be expected and what those parameters may be. It would be up to those replying to be able to meet any specific -- be able to meet specific needs. I'm sure they would have a learning curve.

Q. And do you expect that learning curve to be any shorter than Avista Energy's learning curve?

A. I have no idea.

Q. Now, to the extent that it takes -- or that there is a learning curve and we do bid this out, someone new arrives on the scene. For some period of time, are Avista's customers exposed to increased risk and price exposure?

MR. TROTTER: I'll object to the question. The witness testified that he had no idea the extent or even if there would be a learning curve, so the assumption assumes a fact not in evidence. I'll object to it.

MR. MEYER: I'm sorry. Maybe I didn't hear the last response. I thought he acknowledged there would be a learning curve with a new person arriving on the scene.

Q. Would there be?

A. There would be a learning curve for -- if we're assuming that it was a different party that actually won the request, then I would expect there to be some sort of a learning curve. Whether that transfers into risks for customers is a whole different question.

Q. To the extent that there is, and I won't belabor this, but to the extent that there is such a learning curve, doesn't that -- assume that to be the case. Doesn't that subject the customers to increased risk and price exposure in the meantime?

A. I would actually think not.

Q. So some -- I'm having trouble, I guess, understanding that response. To the extent that a new entity, a new party arrives on the scene that is not as conversant with the mechanism and with the needs of this Utility as Avista Energy is, are you saying that there would be no difference in how much exposure to risk there would be to Avista Utilities' customers. Is that your testimony?

A. My testimony is that, under my alternative, that the company would put the -- not the benchmark mechanism, but the gas procurement function out to -- for competitive bid.

Q. But that wasn't my question. Does the introduction of a fresh face, given the learning curve and assuming a learning curve, does that subject Utility customers to greater risk in the meantime?

A. Not if they're following the gas procurement function formulas.

Q. So you think there is -- you think there is no value in experience in operating a mechanism that Avista Energy brings to the table by virtue of living with the mechanism and understanding the Utilities' load requirements over the past several years?

A. I would say that if this current proposed gas procurement function were put out for bid and Avista Energy responded to that, that they would have a much clearer idea of what they were getting into, as opposed to a third party. Whether the price charged to customers would be any different, I'm assuming that the price charged to customers in the service would be something that would be evaluated by the company during that RFP process.

Q. I'm not sure you've answered my question, but I'm going to move on. Has Avista Energy generally shown a cooperative attitude by its willingness to open its books and records to audit by this Staff?

A. Yes.
Q. In fact, do you know of any instances where it denied a request for information from you?
A. No.
Q. Do you know whether other third parties who are not affiliated with a company would show the same cooperative and forthright attitude producing documents?
A. I don't know.
Q. But you do know about Avista Energy, don't you?
A. Yes.
Q. Another alternative suggested was the assignment of all transportation capacity to Avista Energy.
A. Yes.
Q. Are you recommending that the Utility, as an option or as an alternative, should assign all of its transportation rights to Avista Energy and then simply have the Utility pay only for the transportation it needs?
A. That was what one of my alternatives proposed, yes.
Q. Okay. Would you agree that Avista's annual load factor is in the vicinity of 35 to 40 percent?

A. I'm trying to think if I have the specific numbers to calculate that someplace, but that --

Q. Sound about right?

A. For purposes of this discussion, sure, I guess I would accept that. I don't know for sure if that's the number, but I guess, for purposes of this questioning, it's fine.

Q. Very well. Assuming that to be the case.

A. Okay.

Q. Under such a scenario, given a 35 to 40 percent load factor customer, would Avista Energy be required to essentially accept the risk of holding and paying for the capacity until the Utility decides that it needs to call on it for peak day purposes?

A. I don't think it would operate that much differently than it would under the current mechanism, other than Avista Energy would then have a greater incentive to maximize its capacity releases and off-system sales.

Q. Yeah, but wouldn't Avista Energy, under the scenario I described, be essentially providing standby on-call service to meet peak day deliverability at virtually no cost to the low load factor utility?

A. That would be a tradeoff that it would have for the ability to be able to manage those capacities and collect the revenues for those.

Q. Do you have any idea of what the expense would be to Avista Energy of holding capacity in reserve and without compensation until such time as a 35 to 40 percent load factor utility might call on it?

A. Well, I've looked at the numbers based on what currently happens, and that shows up in my Exhibit 11.

JUDGE MACE: That would be Exhibit 211.

THE WITNESS: 211, yes.

MR. TROTTER: Just wait a moment. I think we're ready, Mr. Parvinen.

THE WITNESS: All right. This exhibit shows the impact to customers based on my second and third alternatives, as compared to what the customers would pay under the company's proposal. And this would be for Northwest Pipeline demand cost.

Q. So what would be the cost to Avista Energy of simply holding that capacity in reserve?

A. Approximately seven and a half million dollars.

Q. I see. This first -- or this mechanism was first adopted in its original form in 1999; correct?

A. Yes.

Q. Would you agree that, through time, this mechanism has been adjusted and modified to take into account changed market conditions, as well as suggestions from Staff and others?

A. Yes.

Q. Has it also been accepted, in one form or another, by three separate regulatory jurisdictions, Idaho, Oregon and Washington?

A. Yes.

Q. By the way, have you talked to your counterparts in the past several years and the other Staffs of Oregon and Idaho about how they feel about this mechanism?

A. I have talked to Idaho. I have not talked to Oregon. I've looked at the mechanism -- and actually, Oregon's, because of the way Oregon's capacity and supplies were treated prior to the mechanism, Oregon being a distinct kind of a subset, treated separately, it was less of a factor, but I have talked to Idaho.

Q. Okay. As far as you know, of record, are the other commissions, do they remain supportive of this mechanism?

A. The Idaho Staff member that I've talked to actually seemed pretty indifferent in that they didn't see great harm or, you know, harm or benefits going forward. What I had talked to them specifically about the last time was how they would react if this Commission were to terminate the mechanism, what would happen to the Idaho mechanism.

Q. Do you recall the discussion around Bench Request Number 1, which was a tabulation of benefits derived?

A. Yes.

Q. Do you have that in front of you, in fact?

A. Yes.

Q. Actually, you may not need this for purposes of the question. I'm just going to put it bluntly and as directly as I possibly can. Can you say that the customers of Avista have derived no benefits from this mechanism over the past three years and that they would have been better off without it?

A. I would say that we would not be able to determine that. I mean -- this is the crux of what's been the ongoing problem, is identifying what it actually costs Avista Energy to serve Avista Utilities. Without knowing exactly what it costs Avista Energy to serve the Utility, we don't know whether customers have gotten a good deal or not.

Q. Do you know -- let me just, so I'm clear on that, do you know whether customers would have been better off without this mechanism? And if you don't know, that's fine.

A. I don't know.

MR. MEYER: We're finished, and thank you.

JUDGE MACE: Commissioners.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Yes, I have some questions, and I'm just going to go straight through my book with stickies marked Parvinen, and it may be that some of these questions have been answered already, but -- so let's begin with Bench Request Number 2.

A. All right.

Q. There was testimony earlier today that in the future there may be more excess capacity in some corridors because of either new construction or changes in industry demand. Do you -- and that the result of that would be to reduce the advantages, I guess, of basin optimization. Do you agree with that proposition, just in a general directional sense?

A. If, looking at that incident alone, I would say yes. I guess to preface that, I would also say that there would be other incidents that would change values. I think one of the main drivers is, as an example, is the Kern River expansion. When that came online, it had a tendency to free up the Rockies gas and bring that basin more in lines with Sumas and AECO. Whenever there is an -- some sort of incident that changes gas cost, it has a tendency to create a basin differential.

Q. So are you saying that increased pipeline capacity doesn't necessarily reduce these differentials; it just shifts them?

A. No, I guess, by itself, an increase in transportation reduces the value of excess capacity in the near term.

Q. All right. Is there any dynamic that offsets that phenomenon? I thought -- it sounds to me as if your later answer is yes, new construction will have a tendency to reduce the value of basin optimization; is that correct?

A. Yes.

Q. And but earlier, I thought maybe you said there's some other factors at play that might take things the other way. Is that correct or not?

A. Well, I guess my earlier comment went -- what I was trying to say was there could be other events that would change, at least on a temporary basis, what the basin differentials would be.

Q. All right. But on a long term basis, more capacity means reduced benefits from basin optimization?

A. In general, until the growth grew into that capacity or something else actually uses up that capacity.

Q. Okay. So a growth in the economy, for example, might increase demand and --

A. Yeah, I was just thinking growth and demand area.

Q. All right. Well, now -- I'm looking now at Exhibit 53, page three. This is the comparison chart.

A. All right.

Q. It's gotten some attention. Well, first, with respect to line 16 that's currency, do you agree that if Avista Utilities really wanted to make sure that it would face a zero from changes in currency, it would have to buy a hedge, financial hedge?

A. I guess if it wanted to insure it to be zero, it would buy a hedge. I don't see why it would want to, given that I'd expect over time to range around zero.

Q. All right. But I guess in my mind, I would put some kind of value in there if you really wanted to make sure it was zero. That is, would you guarantee -- here's another way to put it. If I'm Avista Utilities, would you guarantee me a zero effect for zero price?

A. I would say, over time, it's going to be zero. It's going to have ups and it's going to have downs.

Q. Well, between now and 2007, would you guarantee that to me for no price? Wouldn't there be some price? I don't know big or small, but it's something.

A. It could be negative. In fact, when we looked at the numbers over the time period, there's been a lot of discussions around the confidential exhibit that looks similar to the Bench Request 1. During that time period, from September to February, that currency number is actually negative.

Q. Oh, I know, looking backwards, of course it could be. But if you're looking forward, if you want to have no risk up or down, don't you go to a financial currency hedge seller and buy a hedge and it would cost something? Maybe it would cost very little. I'm talking really about risk, I think.

A. Right, or it's built into the company's overall risk, risk portfolio that's embedded in the rate of return.

Q. Does avoidance of risk have a value?

A. That's a tough question. I guess yes, it would have a value. It would have -- that value would have to be weighed against the cost.

Q. Yes, yes, surely. And if the price of avoiding the risk seemed higher than your own personal assessment of cost, you wouldn't go and buy the hedge?

A. Right.

Q. On line 17, I am unclear here whether you are making an assumption that Avista Utilities could do as good or better a job as Avista Energy in controlling volatility?

A. What I'm saying is -- actually, what this number is demonstrating is that, by using storage on a daily basis to manage your peak, you can avoid the cost that the company put in there. Their number was strictly a calculation of every single day during the period when you're either above or below your average load, either buying or selling in the market, but yet they've testified that they can use storage on a daily basis. So if, in fact, you do use storage, you can control and eliminate those costs. There's some other factors that go into that number, but that's the main --

Q. Okay. But if you -- let's say you don't have the storage ability, and again, you know you're facing some volatility day-to-day. I'll use the hedge example. Again, do you agree that you could go out and buy a hedge to insulate the company from any volatility for a price?

A. For a price, yes.

Q. All right. And then, so -- and if the company did that, it would then gain the opportunity on the other side of the equation to use its basin optimization to buy and sell gas or capacity; right?

A. I'm actually -- I'm not sure how much that would impact if they hedge that small percentage, because that's based around an average of zero. Over the year, you're going to -- the idea is that you're going to average zero; it's just the volatility throughout that day. Sometimes you have to buy, sometimes you have to sell, so in order to hedge that, I think Mr. Gruber testified to this, that they'd be buying a put and call type mechanism that would allow you to either buy gas on those days you needed it or not take it on the days when you didn't

need it. So I'm not sure how that would play into the basin differentials.
Q. I think what I'm trying to get at is, to say there's no cost, that might be true if you use some of your storage supply to balance load?
A. Yes.
Q. But that doesn't mean there's not an opportunity cost there. One way or another, you either have -- you forgo your opportunity to use that supply for some other purpose on the market or you preserve that opportunity and buy a hedge of some other kind. I think what I'm trying to get at is there's not a zero cost to balancing load?
A. Right.
Q. There's a cost of balancing a load and either you buy it, either through -- directly with a hedge or with -- through Avista Energy, or you use your own facilities for your own purposes, in which case you don't have them available for some other purpose?
A. Well, and that's what I -- I guess, when it comes down to it, that's what I'm saying storage is. Storage is that hedge. Storage, you know, the company is a one-third owner in Jackson Prairie storage facility, so they're paying for that facility

to be able to use. Its primary benefit comes from the summer-winter differentials. If, like it's turning out this year, that that's a negative number, well, where's the great value in storage? It can also be used to manage your daily loads, and that's a true value, because it's a hedge against incurring these higher costs.

Q. Yes, but then what -- aren't we comparing here whether Avista Utilities should be doing that directly or should they be permitted to contract with Avista Energy to do the same thing for certain prices going back and forth, and we're really just talking about whether the conditions, such as the three million guarantee and the 900,000 and the 80/20 splits are the appropriate price to pay, along with auditability, I think.

It's probably getting late in the day, and that's why these questions aren't coming out very well. It is getting late in the day. I'll move on.

On line 18 and 19, I don't understand the comparison very well. I understood the adjustment, the 230,000, but if Avista Energy goes forward with this instead of Avista Utilities, would you expect them to realize a similar figure of 230,000, instead of this two million?

A. By using 230,000, that would be saying that Avista Energy would be able to provide $230,000 in benefits more than the Utility would be expected to achieve.

Q. Oh, okay. All right. So does that 230,000, is that your assessment of the value of Avista Energy doing the job instead of Avista Utilities?

A. Yes, I guess that would be one way to put it.

Q. So I'm trying to translate this through in terms of what that means for your judgment about the value of the contract?

A. Well, I guess what that would show is instead of having a -- my analysis showed that I believe the Utility would be able to perform this function at least as well as the outcome of the mechanism by a million-six. That number would then be reduced by 230,000.

Q. All right. Part of the problem is when you have the negatives and the positives, it's hard to remember what you're tracking at what time.

And well, I'm looking at page eight now of Exhibit 53, and there's already been discussion of this, where Avista here feels that you are -- you've double counted benefits. And I'm just wondering what your response to this charge is?

A. All right. I don't believe I have double counted the benefits. Mostly that's due to drawing the assumption that it's zero. Now, if I were to use the $2 million as shown in scenarios one and two, then I would be double counting. The peaking benefit that the company shows is for those -- over this this three and a half-year period, there was 41 days that, for peaking needs, you could pull from storage and then replace those volumes in the future at a price that was cheaper than that daily amount. So that would be included in either scenario two or three, but in my analysis, it was not double counted.

Q. All right. Well, now I'm looking at Exhibit 102, page two, lines seven to nine, and this is about you and Ms. Elder. It says, What they both do not seem to appreciate is that the market sets the value of the capacity based on what is traded at the receipt and delivery points of transportation corridors. As long as there is a positive differential between the two points, then the transport has value.

There's another sentence, but then line 12, The market is extremely efficient and will not pay above that level, which is contrary to what Mr.

Parvinen and Ms. Elder proposed. I'm wondering what your response to that is?

A. I don't think it's contrary to what -- or at least --

Q. Just what you proposed now?

A. Right. Essentially, that's what off-system sales do. And the way they're calculated throughout this formula is it's taking the difference in the values between the basin differentials. Sometimes that's worth more than the full tariffed rate that you could get from a capacity release and sometimes it isn't, but I don't disagree with this description of what -- how the market calculates that value.

Q. Well, do you agree with the statement on line four, three and four, that they assert that Mr. Parvinen proposed that Avista Energy has little, if any, risk with respect to recovery of transportation costs?

Do you agree with that statement that they have little, if any, risk with respect to recovery of transportation costs?

A. Yes. I'm assuming this is in regards there to the guaranteed level of capacity release, off-system sales, because in my testimony I've testified that they have virtually no risk of achieving that level.

Q. And what level are you talking about?

A. The three million.

Q. Then next, on page seven of Exhibit 102, and I'm looking at lines nine to 12 or so. So Mr. D'Arienzo says that the value that you want to capture by changing basin weighting percentages is already being captured through other elements of the benchmark, and it goes on to demonstrate. And do you agree that it's already being captured or not enough of it's being captured or it's not being captured?

A. I would agree that some of it is being captured. If the basin weightings aren't changed and those go towards pricing of Tier 1 and Tier 2, if they're not changed, that creates more potential for basin optimization, of which Avista Energy would get 20 percent. Eighty percent of it would go back to the customers.

If, for example, it was changed more often, there would be less opportunities for basin optimization, that would mean that more value then would be directly transferred back to customers more often, rather than just once a year, twice a year.

Q. All right. And then you had a discussion about what the effect would be on long-term supply, and I wasn't certain what your answer was -- supply contracts. I thought I might have understood you to say whatever contracts were in place would be a constraint on the ability to rebase these percentages. Is that what you meant?

A. Yeah, we were discussing capacity release contracts, and the company has the option -- when it has excess capacity, it has a number of options that it can do with that capacity. It can release it outright for short-term or long-term contracts. If it releases for a long-term contract, then, when it comes time to set that basin weighting, that capacity is not available then to use for the Utility, so that would affect those weightings.

What I was saying was that that's exactly right. It would affect those weightings. It may not be available and it can be adjusted accordingly.

Q. So you would not be intending to prohibit the execution of these longer term contracts, but that, if that's the case, it would then limit the amount of rebasing that could occur, wouldn't it?

A. Right. Right now, Sumas and the Rockies can vary between 18 and 25 percent. Some of that is constraint by existing capacity release contracts. If they signed more contracts, then that may only be able to go up to, you know, 20, 22 percent, you know, some range below 25. On the other side, if some of those current releases were to go away, there would be the ability to go beyond 25 percent. But you can adjust those weightings accordingly to take into account the long-term capacity release contracts.

Q. So you're suggesting that wherever Avista Energy or Avista Utility, I guess, arrives on October 1st, they reassess their situation given whatever business judgments they've made in the past to execute some longer term contracts that use up some of the capacity; is that right?

A. Yes, and actually my testimony went beyond that, even to the point where if it were changing -- that it didn't -- that the company should be adjusting or making its decisions based more on price, as opposed to the basin weightings. You know, if it had an opportunity to do a long-term capacity release -- maybe that's a bad example.

For example -- okay, if it had the opportunity to enter into a hedge at one of the particular basins because it seemed right, but it would drive -- if 18 percent were the current percentage in place and it would drive that range above 18 percent, the company should not be precluded from entering into that hedge. I think they should enter into that hedge, and the weightings automatically adjust for that.

Q. I'm trying to get a sense of what the difference really is. If the percentages are set only once a year, and let's say we're under the scenario now where Avista Energy is doing these functions, then Avista Energy still really actually has this ability to do basin optimization at an 80/20 split. So whatever benefit there is to be had will go at that amount. Is what you're saying is but Avista Energy -- or Avista Utility would get 100 percent on, say, October 1st if things were rebased at that moment?

A. Let me say it this way, see if this clears it up. There's actually -- I don't see that big of a difference. What I am saying is that, by adjusting it twice a year, by the use of the basin optimization, Avista Energy gets 20 percent of the benefits, Avista Utilities gets 80 percent. When the basin weightings are changed, it's like starting over, okay. We've got to create more basin differentials to be able to go beyond the new weightings. It's during those six months -- Avista Energy has no control over what the basin values are.

They just utilize those when they're doing their basin optimization. So allowing them to earn 20 percent during that six-month period on something that they have no control is basically what I was identifying.

Q. But they also lose 20 percent if things don't work out, if the differentials work against them; right?

A. Well, there wouldn't be a -- there shouldn't be a loss situation under normal operations; they just wouldn't enter into the transactions.

Q. I see, okay. Well, then could you turn to page nine of this same exhibit, 102? And there's a chart and it demonstrates that -- or it's here purporting to demonstrate that the cost of scenarios one and two drastically outweigh the benefits of scenarios two and three. And I'm wondering if you agree with that chart, either in its general direction or the magnitude of the difference?

A. Well, there was a little bit of confusion on how we interpreted the chart, but the total number, where it shows a negative $7.9 million --

Q. Mm-hmm.

A. -- where that shows up is in Exhibit 55-C, over in the total column, the third number down.

Q. Yes.

A. So by showing that -- the negative number, that's an additional cost.

Q. Cost to whom?

A. It would be a cost to the Utility if the Utility were doing this function, and that's what this Exhibit 55-C was demonstrating as what it would cost the Utility if it were to bring the function back in to the Utility.

Q. Yes. Well, I thought this was a backcast of the proposed mechanism?

A. It is. It is.

Q. And so it does show -- so if we had used this mechanism in the past, then you're saying some of these numbers show up as a cost to the Utility?

A. It would show up as a net cost, yes.

Q. Okay. But I guess my -- I was just trying to get a judgment from you whether you agree with this table?

A. If you're looking at it from the Utilities' standpoint, if the Utility were to pick up this benchmark and buy and sell its Tier 3 supplies as proposed -- as demonstrated here in the daily market, the 7.9 million would be an additional cost. It's shown as a benefit because currently Avista Energy would be doing that, so it would be a benefit to the Utility.

Q. Okay.

A. So if the Utility were doing it, the negative numbers would be a cost, the positive numbers would be a benefit, and that's where I said that the benefit numbers the Utility would go ahead and do and it would be able to avoid those negative numbers, which would be costs, by using storage.

Q. All right. But that -- now, again, does that assume that Avista Utility is equally capable of performing these transactions as Avista Energy? I hope I said that right. Does that assume that -- are you assuming that Avista Utility could do as good a job as Avista Energy in basin optimization and other aspects of managing the load?

A. Overall, I've demonstrated, by showing the 1.6 million in that chart, that the Utility, I believe, would be able to do the mechanism and save customers the 1.6 million.

Q. Well, but isn't that a circular answer? In order to get to the 1.6 million, are you assuming that -- are you assuming that Avista Utilities can execute the same kinds of basin optimization as Avista Energy, because Avista Energy has testified that they have greater flexibility, they can offset surpluses and decreases in a way that Avista Utilities can't because of their size and their risk?

A. I am saying that the Utility will be able to operate -- would intend to operate the same way that Avista Energy is currently using this mechanism. So they would take this gas procurement function, bring it back into the Utility, and operate essentially the same way as Avista Utilities. And one of the numbers that they propose in here is to be able to hire the personnel to be able to operate in such a manner.

Q. All right. So does that mean that you see no value to Avista Energy's size and risk profile?

A. I'm actually -- what I would say is it's not demonstrated here. As an example, I guess we would expect that, for Tier 1 and Tier 2 contracts, those are contracts that either Avista Energy or Avista Utilities could go out and enter into and achieve the same results. That's one of the reasons there's no sharing on those costs. Tier 3 is simply a function of applying the calculation in this case of using those volumes around the average and applying a daily rate to those. Capacity release and off-system sales, I don't see that Avista Energy is deriving a greater value than what the Utility was able to do before or what they've demonstrated through their calculations here what the Utility would be able to do going forward. That's why I proposed the zero number.

Q. Okay. So I guess you are assuming, then, no value by Avista Energy doing these operations, as opposed to Avista Utilities; is that correct?

A. Right.

Q. Well, turning to your testimony, which is Exhibit 201, page three, lines 11 through 13, this is the issue of this being done through an affiliate, and you're saying, therefore, it should be evaluated using the lower of cost or market standard.

I guess I want to ask you the same question I asked Ms. Elder. Isn't it the nature of a hedge or an incentive mechanism that you wouldn't use lower of cost in the market?

A. Well, here we have an affiliate providing a service contract for its affiliate. We have Avista Energy, a non-arm's length transaction, essentially, with Avista Utilities. That needs to be evaluated under a lower cost or market standard to show that customers are paying for -- are paying for the appropriate value. In other words, not subsidizing that nonregulated entity.

Q. Okay. So does that mean, in your view, that if the terms of this were changed and Avista Energy were going to guarantee $6 million, say, instead of the three, that you would say that we shouldn't do it, because we can't verify this issue of actual cost?

A. Right, and that's why it is not one of -- that's why it's not my main alternative. It's the second alternative that said, Okay, if you can't identify what the market value is, because you're not doing an RFP, and you can't identify what Avista Energy's actual costs to provide the service are, my analysis shows what it would cost -- essentially what it would cost Avista Utilities to provide the service itself. So you would need to then, in that case, provide enough benefits from Avista Energy to the Utility to at least be able to provide what the Utility is doing at the cost that the Utility provided.

You're looking at lower market cost or market, I think cost has two sides to it. The cost of Avista Energy providing the service versus the cost of the Utility doing the service itself.

Q. So if this same type of arrangement were undertaken with a third party, would you not have the same qualms because there's not an affiliate involved?

A. Right, it would be different in that, because of the RFP process, the company would ultimately make the decision on whether those costs they're that are being charged from the nonaffiliated entity were reasonable to enter into for its customers. That decision is not as clear when it's doing it with its affiliate because of the affiliate's actual cost to provide that service. A good example of this is the hedge -- or the Tier 1 and Tier 2 cost. A third party nonregulated entity may still enter into those transactions and pass those costs off to the Utility. It could then, because those contracts become part of its own overall portfolio, manage those in any way it seems appropriate. And Avista Energy has the -- or Avista Utilities would have that decision up front on whether or not to enter into that contract.

In this case, because it is an affiliate and Avista Energy enters into those contracts, it incorporates them into its total portfolio, manages it daily, whether they -- you know, they get manipulated daily, whether they're being bought, sold, traded, transported, non-transported, over

Avista Energy's or Avista Utility's transportation, where the actual costs -- the ending cost never gets determined, those revenues are not identified, the cost of trans --

Q. I'm not sure I understand that, because, from Avista Utilities' point of view, it's going to be up front either way, either a third -- either a third party takes on the job or Avista Energy takes on the job, and in either case, Avista Utilities has to decide, based on projections, whether it's a good deal or not; right?

A. But as -- because this is an affiliated transaction, what is the ultimate cost that Avista Energy serves the Utility? That is a clear distinction. If Avista Energy can take those contracts and manipulate those in such a way that it makes a profit, shouldn't Avista Utilities' customers benefit from those? They're providing -- they're providing that cost that otherwise wouldn't be there.

Q. Well, I guess I was trying to compare the situation where Avista Energy is providing the service and it has decided in advance, as we are being asked to approve in this hearing, that this is the arrangement.

Alternatively, a different company could be performing -- a third party could be performing the same function, and let's say it is through an RFP. But in either event, Avista Utility or the regulator has to decide in advance whether it looks like a good enough deal, whether it's an RFP, which has a certain protection built into it, or Avista Energy. And in neither case are you going to know -- how could you know -- what the actual costs are going to be, and in neither case, under this kind of mechanism, would actual costs ever be determinative?

A. Well, I guess the affiliated interest rules provide safeguards so that Utility customers aren't subsidizing a nonregulated affiliate. And that's what the lower cost or market analysis is intended to do, is to assure that that doesn't happen.

Q. And surely it would, but does that really answer the question in front of us, because it seems like a given that we will not be able to ensure the lower cost or market with this mechanism. Aren't we just trying to decide if this mechanism that is not the lower of cost or market is nevertheless in the best interests of the ratepayers because of the incentives and payments and that sort of thing?

A. I guess that's what my alternatives were based on, if the Commission were to determine that the lower of cost or markets either shouldn't apply or can't be determined, then to assure that proper benefits are applied to customers, that's where the alternatives came into play.

Q. Okay. There was a question, and I really don't remember whether it was Mr. Trotter or Mr. Cromwell, but it asked what if it were more suitable to buy 60 percent, not 50 percent of Tier 1 purchases. Doesn't this proposal lock in a particular ratio, i.e., 50 percent Tier 1, 50 percent Tier 2?

And I was wondering what your feeling about that is? Is 50/50 as good as one can ever really get in advance? Good -- well, I'll leave it at that.

A. This benchmark mechanism, it was designed -- it's a purchasing strategy that includes 50 percent hedged and 50 percent first of the month. Those are levels that the company, Avista Utilities, in consultation with Avista Energy, has decided is the appropriate level, at this point in time, to go forward with to provide some rate stability towards customers by doing hedges, to provide assurances that, at least during extreme peaking periods, price spikes, that customers are sheltered from those somewhat.

Q. Are you comfortable with that approach, the 50/50 part?
A. I mean, at this point in time, I think that strategy doesn't seem to be -- it doesn't seem to be an adverse strategy. You know, if you look at all the other LDCs, they all have a different strategy, and that's a management decision. Those management decisions in this case are getting locked in by tariff.
Q. All right. Then, on page 18 of your testimony, on lines 15 through 21, you quote a Commission order from 1992, and do you know what the mechanism was in that case, what kind of arrangement?
A. It was in the context of a general rate case?
Q. I don't know. This is --
A. No, okay. If that's --
Q. Well, you're making the point here -- well, that in earlier cases, we have said, and I'm quoting from this sentence, The ratepayers should not be required to support a company's purchases from an affiliate at a price greater than the company would pay for comparable supply in the open market. What I wondered was, was this a pass-through of cost, was there an incentive mechanism, did there -- were there

any guarantees? In other words, did the structure that the Commission was looking at at that time resemble or not the mechanism in front of us?

A.   No, there was no mechanism like we have in front of us. This was in the context of a general rate case reviewing the affiliate, Washington Energy Exploration, which was -- was a gas provider.

Q.   Okay. Then, on the next page, 19, this is -- you know, lines one through 11, this is a place where we applied the lower cost or market standard, and again, was there any kind of incentive mechanism or guaranteed payments in the -- in the WIDCO case?

A.   No, in both of these examples, in the first one, the Washington Exploration had a contract to provide gas to Washington Natural Gas at a certain price. The issue was was that price at market, and it was determined in that case that it was not at market, so that price was adjusted down to market.

In the next example involving WIDCO, the practice was to -- WIDCO provided coal to Centralia, and WIDCO was a subsidiary of Washington Water Power. At that time, the coal prices were adjusted to WIDCO's actual cost, including a fair return.

MR. TROTTER: Your Honor, I'm sorry to interrupt, but Mr. Parvinen's been on the stand now for 95 minutes, and I was wondering if it would be appropriate to take a break?

CHAIRWOMAN SHOWALTER: Actually, I think I'm down to my last question or two, so --

MR. TROTTER: That's fine. Just a suggestion.

CHAIRWOMAN SHOWALTER: Are you all right?

THE WITNESS: I'm fine.

Q. I think that is all my questions. Thank you. No, I'm sorry. I'm sorry. You said you had spoken to the Idaho Staff. Did you detect any concerns if we have a different mechanism than they do, such as Avista Utilities doing this -- not a different mechanism, actually, if we move this function back into Avista Utilities?

A. Well, the discussion that I had with a Staff member over there, I think -- and I can't remember his name offhand, but I think it was the Staff member that was involved with looking at the mechanism at least the last time it was approved, and I had mentioned -- told him what our recommendation was in regards to this, and getting his feedback on how they may view that -- if our Commission did away with the mechanism, how they would view that in Idaho.

His comment was that if the Commission here were to determine that there were more benefits that would go to customers by having Avista Utilities take on the gas procurement function, and then the Avista Utilities was able to demonstrate that situation to their Commission, that they would probably recommend that it -- recommend early termination, or early cancellation. I'm trying to think of the word. But that would only be if the Utility were to file with that Commission and demonstrate that there would be more benefits.

Q. Just, it would seem that there is an efficiency or economy of either Avista Energy doing this for both Washington and Idaho or the Utility doing it, but if the function is split, wouldn't we be splitting common costs and expertise and, therefore, maybe causing both states more than would be the case if it was all one place or all the other?

A. Well, Washington would certainly pick up all the cost of providing the gas procurement function, and that's built into the analysis. As far as efficiencies go, I'm not sure exactly how Avista Energy or the Utility would bring the capacity back to the Utility --

Q. Well --

A. -- without doing it in Idaho.

Q. I mean, I just mean that the decision on any given day, I would imagine either Avista Utility or Avista Energy would be very similar for Washington and Idaho, if not identical, if it's being made in one place or the other, but if those very same decisions are being made in two places, I would think you'd have essentially double costs, double costs of the administration, anyway?

A. Well, I know that Washington would be picking up all the cost to be able to --

Q. Right.

A. -- do the gas procurement function on its own. You know, they've stated that they would be able to do that and in their testimony said that they would intend to keep Idaho and Oregon under the mechanism. And like I've said, I don't know exactly how that would work in practicality.

CHAIRWOMAN SHOWALTER: All right. Well, thank you very much. I guess we need a little break. Why don't we go off the record.

(Recess taken.)

JUDGE MACE: Let's be back on the record. Let me indicate we've had an off-the-record discussion about briefing, and the parties will be filing initial briefs on December 22nd and reply briefs on January 9th, 2004. And the parties have agreed, at this point, at least, that the reply briefs will be limited to 20 pages in length, with the option to request the opportunity to provide additional reply if it looks like the situation merits it.

Let me turn now to the other Commissioners, if they have questions of Mr. Parvinen.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. I have a few, and I'll try to make this terse, if I can. You were asked in the discussions about Exhibit 211, about the cost of holding capacity in reserve, as I understood the question, and your answer was approximately seven and a half million dollars. Is that a fair statement of that exchange?

A. What -- I guess what I was saying was that the total cost of the transportation for TF1 demand cost is $9.7 million. That's shown on line 13.

Q. Yes.

A. It's also shown on line one, but that's the total cost of TF1. Under alternative three, what the customers would actually pay for in demand costs would be 2.1 million. That's on line eight.

Q. I see.

A. So that difference would be demand costs that Avista Energy would be obligated to pick up. Those costs would then be reduced by the total amount of capacity release, off-system sales that it would be able to achieve. And this is under alternative three.

Q. Okay. So that's how the number seven and a half million was derived?

A. Yes.

Q. All right. Thank you. And in the question and answer on cross, I think this was answered, but your alternative of going out to the RFP would provide the opportunity for Avista Energy to be a bidder, also, or to be a bidder for that RFP?

A. Yes.

Q. All right. And so other bidders who would come in at least would give -- to use the word benchmark against to measure, I suppose, the greater experience, taking into account price, that Avista Energy would provide?

A. Right.

Q. The issue has been raised, were that to be done, that there would be measurable difficulties in auditing. Do you see that as a problem if it were --

were the bid to be awarded to a third party?

A. Right. I would suspect that auditing of a third party's costs would be a problem. What we would get out of an RFP is theoretically the cheapest provider or at least the least cost provider of the service of this type of gas procurement function, whether that be Avista Utilities -- and I guess I would see that as the -- as the target to beat. This is what Avista Energy will do it for. Is there another alternative that could provide the service at a cost less than that.

That would then be a market cost. We would have -- we would not have the ability to go out and audit the numbers behind the ultimate charge from that customer. It would -- I guess it would simply be an invoice to Avista Utilities, and that would be their cost of gas.

Q. Would it be appropriate or desirable to require in any such RFP that an opportunity for audit by Staff would have to be made available?

A. I guess it would depend on how it was designed. It might preclude parties from entering into the bid if the ultimate outcome were subject to change via an audit from the Staff. I guess what the RFP would do would then provide what the actual market value is of this service regardless of the cost behind it.

Q. Okay. I want to take just a moment and review the history of Avista Energy. Now, you've been with the Commission for approximately 15 years?

A. Yes.

Q. And you've spent all or substantially all of that time on the gas side?

A. Pretty much.

Q. Okay. So I take it you know the history of the evolution of Avista Energy?

A. Somewhat, at least in general.

Q. Okay. Well, let me describe it and see if you agree with this, that say 10 years ago the -- on a much reduced basis, the activities of buying and selling in the market was part of the activities of the Utility itself, wasn't it?

In other words, on a much reduced basis, the kinds of functions that Avista Energy is now doing were being done by the Utility itself. They were buying and selling in addition to their buying and selling for their own needs?

A. Yes.

Q. And then, as that business grew, then the company made the decision, and I think -- I can't recall if we approved it or not, that function was put outside or put into an affiliate, so -- to separate out those market transaction functions from the buying and selling for the Utility itself. Is that your understanding of history?

A. Well, I think Avista Utilities -- I mean, it was more focused on the gas side, it was more focused on providing the needs of its own service. As the market started to develop, it might even go -- it goes back beyond Avista Energy, when it developed a company called Develop Associates -- Development Associates, which is somewhat similar, that it was a gas marketer, but it did not provide any services to the Utility, but it did go out and do a lot of the marketing functions.

Q. You state it better than I. I mean, so when there was that separation, then the affiliate was doing buying and selling in the market, but not for the company. The company was doing that in-house?

A. Yes.

Q. For itself?

A. Yes.

Q. Okay. So that was the second phase. Now that the market's continued to develop, now I suppose we're in the third phase, and the company has decided to contract out to its affiliate the in-house functions that it had been carrying on itself?

A. Yes. I guess my own personal perspective is that it seems like the company has, as it started to develop the expertise inside, that in order to -- in order to take on greater risks and capture greater rewards, it created these other entities, including Avista Energy, to expand on those abilities.

Q. Now, let's assume, for whatever corporate decisions, Avista Corporation decides to sell Avista Energy and to get out of the business. And were that to occur, do you have any opinion as to whether Avista Utilities would then continue to want to contract with now the sold Avista Energy? Say it's sold to, I don't know, Price Waterhouse.

A. I can't recall if there's anything specific in the contract that would cover that, and I --

Q. Well, I'm not really asking that question. I'm asking as to whether the Utility would see it's in its interests to contract out?

A. I would say, based on its rebuttal testimony and its reaction to actually putting this mechanism out for bid, I don't think that they would care for that type of arrangement.

Q. Does any other gas utility that the WUTC regulates, the other three, do any of them contract out this function?

A. No.

Q. Do you have any opinion as to how common contracting out in some form the gas purchase mechanisms occurs in the industry for, say, mid-size to larger utilities?

A. I know it does occur, but I don't know how widespread it is, how often, how many.

Q. Are there any others in the Pacific Northwest?

A. IGI, in Idaho, contracts out.

Q. And how large a company is that?

A. I -- I don't really know. I think it's the biggest gas company in Idaho, but I'm not exactly sure the size.

Q. Do you know to whom they contract?

A. I believe it's with an affiliate, Intermountain Gas, which was --

Q. So they contract with their -- an affiliate of the company itself?

A. Yes.

COMMISSIONER HEMSTAD: That's all the questions I have.

COMMISSIONER OSHIE: I don't have any

questions.

JUDGE MACE: Mr. Trotter.

MR. TROTTER: Thank you, Your Honor.

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

BY MR. TROTTER:

Q. Mr. Parvinen, would you turn to your Exhibit 209-C? And am I correct that this is an exhibit that supports your Exhibit 208?

A. Yes.

Q. And then the table on 208 is also used in Mr. Gruber's rebuttal testimony, page three?

A. Yes.

Q. Okay. You talked about one of the conservative assumptions you used in the company's favor on line 21. Do you recall that?

A. Yes.

Q. I'd like you to focus on -- I believe it's lines -- line 13, and you show a confidential number ending in 874?

A. Yes.

Q. Does that reflect a conservative assumption in favor of the company on your part?

A. Yes, I believe it does. This represents revenues that the Utility would not have entered into based on how it was organized in the past. I believe that, on a going forward basis, because the market has changed and the fact that it would cost more dollars to bring people in to do this type of a function, that there would be some level of dollars in this category, but to be conservative, I left it at the company's level.

Q. Do you recall examination yesterday regarding the 1997 IRP?

A. Yes.

Q. And I believe Mr. Gruber agreed that the company itself was looking at additional ways to better manage its resources. Do you recall that testimony?

A. Yes.

Q. And do you agree that the company would be, if it had this function between 1999 and present, be managing its resources in a more efficient manner?

A. Yes, and they testified to that yesterday.

Q. Turn to 62-C. Just by way of background, you were asked a question whether Avista Energy ever denied you any information. And in this data request, did you ask the company to produce the fair market value of Avista Energy's use of Avista Corp, the Utility's gas storage capability under the mechanism?

A. Yes.

Q. Is it fair to say that the company did not provide that figure?

A. Just give me a minute to read it.

Q. I'm just focusing on line three of the second paragraph of the response.

A. That's correct.

Q. Are you aware of any calculation by the company, and I mean Avista Utilities or Avista Energy, of the value to Avista Energy of using Avista Corp, the Utilities', total gas portfolio in Avista Energy's own gas portfolio?

A. No.

Q. Did Avista Energy get its contract with Avista Utilities for this gas procurement function through competitive bidding?

A. No.

Q. Did it get the contract by an arm's length negotiation?

A. No.

Q. If there were competitive bidding, would that tend to require bidders to value the benefits they get from the day-to-day and year-to-year and month-to-month use of Avista Utilities' gas portfolio and other -- and related assets?

A. Yes.

Q. You mentioned discussions with the Idaho Staff. To your knowledge, has the Idaho Staff -- did the Idaho Staff spot the issues that you have raised in this proceeding?

A. No, I'm not aware of it. I know they seemed surprised to find out the magnitude of the basin differential benefits that were going to Avista Energy.

Q. Does the company report those basin optimization benefits in its quarterly reports with this Commission?

A. No.

Q. You stated that there was little risk to Avista Energy with respect to the three -- reaching the $3 million for off-system sales and capacity release revenues under that guaranteed section of the proposed mechanism. Can you explain why there's little risk?

A. Yes, a couple of reasons. First, based on the company's own calculation of what they projected that the Utility would be able to achieve, would have been able to achieve over this last time period, which seems pretty consistent if you look at Bench

Request Number 1, those numbers seem to be pretty consistent. And so looking historically to go forward, the Utility, under the company's analysis, would be able to produce about 6.3 million a year in capacity release off-system sales.

Also, by looking at Exhibit 257-C, the last line in that first paragraph of the response shows that the bulk of releases precede the benchmark mechanism, indicating that at least a majority of the capacity releases that are obtained were a result of deals that were entered into prior to the mechanism.

Bench Request Number 2 shows that that number has been fairly consistent, around three million, just above three million.

Q. And let's turn to Bench Request Number 2 for a moment. And this exhibit does not reflect basin optimization benefits, does it?

A. No.

Q. And could you focus on the entries for 2002? There's 1.6 million for off-system sales. Do you see that?

A. Yes.

Q. Are you familiar with what Avista Energy was doing in the basin optimization aspect of the mechanism during that time frame? My question is whether you're aware of what they were doing?

A. At the time?

Q. Yes.

A. No.

Q. But with respect to basin optimization in 2002, any benefits in that category went 100 percent to AE; correct?

A. Yes.

Q. Can you explain the interplay between the off-system sales figure here and the basin optimization benefits in that period?

A. Yes. Primarily, Avista Energy has the choice of either entering into an off-system sale or doing the basin optimizations. It's taking -- using the capacity and getting the value of that through an off-system sale or using that capacity to serve the utility from the cheapest basin, which is what basin optimization is.

So during 2002, if the company were using, and it appears to be the case in 2002, using the Rockies capacity to serve the Utility, it was foregoing off-system sales opportunities that then would have flowed back to customers 50/50, once it got beyond the -- actually, I believe it was until April of 2002, it was -- there was a $3 million guarantee for capacity release, off-system sales, and then they were shared 90/10, 90 percent to the customers in April 2002. That changed to the first five million to customers; beyond that, 50/50 to Avista Energy and to customers.

Q. And is it your recollection that there were approximately $4 million in optimization benefits in 2002?

A. Yes.

Q. And if those transactions had been off-system sales instead, would the 1.6 figure for off-system sales for 2002 in Bench Request Number 2 be greater?

A. Yes.

MR. TROTTER: Those are all my questions. Thank you.

JUDGE MACE: Mr. Meyer.

MR. MEYER: I just have a brief follow-up.

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

BY MR. MEYER:

Q. Mr. Parvinen, Chairwoman Showalter asked you some questions concerning the normalization of the so-called anomaly caused by this two-month period during the energy crisis. Do you recall that

exchange?
A. Yes.
Q. Okay. Did the company furnish you with information in response to Staff Data Request Number 120, as it relates to this normalization issue?
A. I remember asking the company in a data request -- and I don't recall the number, I'm assuming that the number you referenced is it -- to do a calculation in the same method that I had come up with the 230,000. I know the response was not done how I had asked the company to perform that analysis.
MR. MEYER: May I approach the Witness?
JUDGE MACE: Yes, you may.
MR. MEYER: The record should reflect that I'm handing to the Witness a response of the company to Staff's Data Request Number 120.
JUDGE MACE: I'd like to mark this for purposes of identifying it, and it will be Avista Cross 214.
Q. Do you recognize what has been marked as 214 as Avista's response to your data request?
A. Yes.
Q. And does that response address the issue of normalizing for the so-called anomaly period during

the energy crisis?
    A.   Yes.
         MR. MEYER: I'd ask that what has been marked for identification as Exhibit 214 be introduced into the record, please.
         JUDGE MACE: Any objection to the admission of 214? I'll admit it.
         MR. MEYER: With that, I have no further questions.
         MR. TROTTER: I may have one.
         JUDGE MACE: I'm sorry?
         MR. TROTTER: I may have one follow-up.
         JUDGE MACE: Mr. Trotter.

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

BY MR. TROTTER:
    Q.   Mr. Parvinen, can you compare and contrast your analysis with the Exhibit 214 analysis regarding the normalization?
    A.   Yeah. Not exactly. The reason for that, I remember when I got this response is that it didn't seem to be responsive to what I was doing or what I asked the company to perform, so I didn't get into trying to determine whether or not these numbers actually made sense or not, so I mean, I haven't

evaluated it.

Q. You're not defending the analysis of Exhibit 214, are you?

A. No.

MR. TROTTER: I guess that's all I can ask, Your Honor. Thank you.

CHAIRWOMAN SHOWALTER: I have a question of almost -- of anybody. That is, I think Commissioner Hemstad's question of what happens if Avista Energy is sold is a good one. And so the question is is there anything in the record that points us -- that gives us an answer to that question? And if not, I guess I would like a bench request to provide the answer to that question.

MR. MEYER: I don't think there's -- that has been addressed directly in the record, so we'd respond in a bench request.

JUDGE MACE: And the --

MR. TROTTER: And I would just point out, Madam Chairwoman, and I'm sure you caught it, but Exhibit 204 is the agency agreement between the two, but I don't know if it addresses it or not. But that's where I would look as a starting point to see if there's any provision in there regarding successors and so on, but --

CHAIRWOMAN SHOWALTER: Okay. So basically, it's either there or not there.

MR. TROTTER: That's right.

CHAIRWOMAN SHOWALTER: I think that's right. I don't need a bench request. Thank you for pointing that out.

JUDGE MACE: Is there anything else that we need to address at this point with regard to Mr. Parvinen?

MR. TROTTER: No, Your Honor.

JUDGE MACE: All right. Thank you, Mr. Parvinen. You're excused.

Is there anything else that we need to deal with on the record at this point about this proceeding? We have a briefing schedule. If not, then the record is closed. Thank you.

MR. TROTTER: Thank you, Your Honor.

MR. MEYER: Thank you.

CHAIRWOMAN SHOWALTER: Happy Thanksgiving.

JUDGE MACE: Yes, and Happy Thanksgiving.

(Proceedings adjourned at 6:23 p.m.)