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January 9, 2004

VIA ELECTRONIC FILING &
OVERNIGHT MAIL DELIVERY
Carole Washburn,
Executive Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Drive S. W.
P.O. Box 47250
Olympia, Washington 98504-7250

Re: Docket No. UG-021584 – Natural Gas Benchmark Mechanism

Dear Ms. Washburn:

Enclosed for filing with the Commission are an original and sixteen copies of Avista's Rely Brief for filing in the above-cited case.

This has been provided to the Commission by an electronic version with the original concurrently placed in overnight mail.

Questions regarding this filing should be directed to Liz Andrews at (509) 495-8601.

Sincerely,

Kelly Norwood

Kelly Norwood
Vice President of State & Federal Regulation

Enclosures

c: Attached service list

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

In re the Matter of WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. AVISTA CORPORATION d/b/a AVISTA UTILITIES, Respondent.	DOCKET NO. UG-021584

REPLY BRIEF OF AVISTA CORPORATION

AVISTA CORPORATION
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BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

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1 Avista Corporation (hereinafter "Avista," the "Utility," or "Company"), respectfully submits this Reply Brief in the above-captioned matter. Avista's Initial Brief attempted to carefully examine the record compiled in this proceeding in order to underscore the evidentiary basis for the arguments advanced by the Company. While this Reply Brief will attempt to do likewise, this Brief also affords the Company the opportunity, now that the issues have been joined, to reflect upon the broader policy implications of the Commission's decision in this docket.

I. THE AFFILIATED NATURE OF AVISTA ENERGY'S INVOLVEMENT WITH THE MECHANISM

2 Staff, in its Brief, calls the affiliated nature of the transaction the "single most problematic aspect" of the Mechanism. (See Staff's Brief, p. 9, para. 27.) Staff then invokes the a "lower of cost or market standard." (Id.)

3 It would appear that Staff has become so concerned with the notion that an affiliate of the Company is involved, that it has paid lesser attention to the bigger question – namely, will

ratepayers benefit through the utilization of Avista Energy's market presence and specific skills, and if so, how can the Mechanism best take advantage of those attributes. The Company has worked hard to demonstrate over the past several years that the Mechanism is workable and adaptable to changed circumstances. It has actively solicited input from Staff concerning refinements to the Mechanism and has proposed changes to address Staff concerns. These are discussed at paragraphs 35 through 37 of the Company's Initial Brief. The Mechanism has been modified to provide greater benefits to customers through the basin optimization process, as well as the greater use of storage in order to cover daily load variability. Other modifications were made to assure that the Mechanism is fully auditable and that there is a symmetrical sharing of risks and rewards on the basis of 80% to customers and 20% to Avista Energy. In this case, it is abundantly clear that Avista Energy, as the affiliate, has opened its books and records for audit; indeed, it has invited scrutiny.

4 Notwithstanding these efforts to gain consensus, the Mechanism still appears to be "high-centered" over the notion that an affiliate is involved. The Company wishes to make it quite clear, if it has not done so already, that it understands the Commission's need to scrutinize carefully any affiliated transaction and it has welcomed such scrutiny. The question, however, still needs to be asked: have Staff and Public Counsel, in their zeal to police "affiliate" transactions, possibly given insufficient attention to the broader public interest considerations and benefits to ratepayers?

5 Clearly, nothing in this Commission's prior Policy Statement on incentive mechanisms or its other pronouncements suggests that one should not deal with an affiliate, even if ratepayers might otherwise benefit. Why not, after all, take advantage of Avista Energy's market presence and expertise, both of which are undisputed. This case affords real opportunities for ratepayers to

continue to receive benefits. Incentives have been carefully structured across all elements of the Mechanism (commodity/basin optimization/transportation/storage) in such a way as to maximize the benefits to ratepayers: for every $1 of additional benefits that Avista Energy may garner, Avista's customers will receive $4 of benefits. Avista Energy is uniquely situated to deliver these benefits. It understands the market, it has the "presence" in the market that Avista Utilities lacks, it understands the nuances of serving Avista's load, and it shares the same commitment to reliable service that its parent utility does. Clearly, its interests are aligned with the Utility. Why not take advantage of these attributes for the benefit of ratepayers?

6 The Company is, quite simply, trying to do the right thing by harnessing the benefits of Avista Energy's scale, scope and expertise for the benefit of its ratepayers. If, in fact, the Company had been attempting to secure unreasonable financial rewards for its subsidiary, Avista Energy, through this Mechanism, why then did it agree, as part of the proposed Settlement in this Docket (since rejected), to terminate the Mechanism in 2005, if it could not, in the meantime, reach agreement with Staff and Public Counsel on further revisions? This hardly suggests the actions of a company that is motivated to secure unreasonable gains for its subsidiary. Simply put, the Company has been open and candid with the parties throughout the process. It has tried to create a Mechanism that parlays the strengths of Avista Energy into realizable benefits for its customers. If, at the end of the day, the mere fact that an affiliate was involved was too much of an obstacle to overcome, then that is the guidance that we need as we operate in the future.

7 The next question to be asked is whether, if the procurement function were returned to the Utility and were the Mechanism terminated, would ratepayers benefit? The evidence of record suggests otherwise. Let's examine the pieces. Staff's ability to audit won't improve, nor will other "external benchmarks" suddenly present themselves for purposes of comparison. The

Company's ability to take advantage of basin optimization, capacity releases, off-system sales, and storage optimization won't be, somehow, enhanced. In fact, quite the opposite is true. The Company's ability to maximize, for the benefit of ratepayers, capacity releases and off-system sales as well as storage and basin optimization will suffer, given the lack of market presence otherwise enjoyed by Avista Energy.

8 As discussed beginning at paragraph 47 of the Company's Initial Brief, the benefits to customers from Avista Energy's greater market presence are tangible. Company witness Norwood spoke to these benefits, noting that:

> 9 Through consolidation of the Company's gas procurement functions under Avista Energy, Avista Energy has been able to pool Avista Utilities' supply, storage and transportation arrangements with their portfolio. This has provided Utility customers additional benefits from Avista Energy's operations, while avoiding many of the risks.

10 (Exh. 1T, p. 7, ll. 13-19.) Simply put, Avista Energy provides the expertise, the sophisticated tools and the involvement in a broader market that Avista Utilities could not otherwise provide. (Id.)[1] Indeed, Mr. Norwood likened Avista Energy's participation to that of a Wal-Mart, with access to "a lot of suppliers, they move a lot of volume, and so they know what the market is . . . they have the pulse of the market. And so they're able to execute these transactions a lot easier than what we are." (Tr. p. 215, l. 20 – p. 216, l. 13.) Avista's Initial Brief served to "catalog" the benefits provided to customers by virtue of Avista Energy's participation in the area of economies of scale, expertise, access to a larger customer base, additional mitigation of risk around currency, daily gas volatility and counter-party risk. In addition, Avista Energy provides a 100% storage cycle guarantee and its management of storage otherwise provides additional operating flexibility to use storage as a hedge. Finally, Avista Energy is better positioned to

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[1] It should be recalled that Avista Utilities' natural gas volumes managed by Avista Energy, in fact, amount to less than 3% of Avista Energy's total business. (Exh. 3T, p. 3, ll. 8-13.)

assist in pipeline optimization, both by way of capacity releases and off-system sales. (See Exh. 52, p. 1.)

11 Finally, the beauty of the 80/20 sharing mechanism which spans across all primary elements of the Mechanism, is that it provides appropriate incentives to maximize opportunities, without biasing or distorting decision-making in favor of one strategy over another (e.g., basin optimization versus capacity releases). We want Avista Energy to be successful, because ratepayers receive $4 for every $1 of benefits received by Avista Energy.

12 As concerns the question of "lower of cost or market," Chairwoman Showalter correctly observed that were a non-affiliated third-party involved instead of Avista Energy, the question of "lower of cost or market" would not arise. The following exchange between Chairwoman Showalter and Staff witness Parvinen nicely illustrates this point:

13 Q: I'm not sure I understand that, because, from Avista Utilities' point of view, its 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 its a good deal or not; right?

14 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.

15 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.

16 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 its 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?

17 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.

18 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 insure the lower cost or market with this mechanism. <u>Aren't we just trying to decide</u> if this mechanism that is not the lower of cost or market <u>is nevertheless in the best interests of the ratepayers because of the incentives and payments and that sort of thing.</u>

19 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 come into play.

20 (Emphasis supplied.) (Tr. p. 520, l. 5 – p. 522, l. 4.) The simple fact remains that, were Avista dealing with a <u>non</u>-affiliated third party, the "lower of cost or market" would not be at issue. As Chairwoman Showalter correctly surmised, from Avista Utilities' point of view, whether a third party is a successful bidder, or Avista Energy continues with the Mechanism, the issue remains the same – is it a "good deal or not." (<u>Id</u>.)

21 It should be recalled that Tier 1 transactions serve to meet approximately 50% of the Utility's average load. These purchases are made in advance at fixed prices, and the market prices at the time the transactions are executed would serve as an external benchmark. As such, they are "auditable" against external benchmarks and reflect the market at the time the hedges are locked in. (No sharing has been proposed for Tier 1 transactions, because the purpose for this layer of supply is to provide a level of price stability.) Similarly, with respect to Tier 2 transactions, constituting the remaining 50% of estimated monthly load, purchases are made at First of Month index prices, which serve as an external benchmark. As noted by Mr. Norwood,

the "benchmark is the index, it is the market, and they're one in the same." (Tr. p. 125, ll. 6-9.) Finally, Tier 3 daily purchases are measured, as well, against an external benchmark (First of Month index costs) and are otherwise subject to an 80/20 symmetrical sharing. The fact remains that commodity costs in each of the three tiers do reflect "the market" – stated differently, cost is market.[2]

22 Moreover, the $900,000 management fee proposed to be charged by Avista Energy only serves to cover a portion of Avista Energy's costs, as testified to by Mr. D'Arienzo. (Tr. p. 403, ll. 1-7.) Indeed, even with the opportunities under the 80/20 sharing aspect of the Mechanism to realize additional gains across several elements of the Mechanism, Avista Energy only anticipates revenues approximating $1 to $1.3 million annually (and that includes the $900,000 management fee).

23 Therefore, even if one were to analyze the proposed Mechanism based on "cost or market" standards, the evidence demonstrates that the "cost is the market" in the case of commodity purchases. Moreover, the $900,000 management fee simply attempts to cover some of the costs to Avista Energy of providing management services and is otherwise well within the range of reasonableness. What the fee does not compensate Avista Energy for, however, is its ongoing exposure to counter-party risk and the risk of non-delivery of commodity. Those risks to Avista Energy are real. As Mr. D'Arienzo explained, if the gas does not show up, Avista Energy has to make good on the transaction.[3] Similarly, with respect to counter-party risk, "it

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2 To lend further perspective to this issue, if Staff's concerns over the "lower of cost or market" are arguably relevant at all to the commodity component, it would only be with respect to Tier 3 transactions which only involve a relatively small volume on an annual basis which is required to balance load from day to day. (These Tier 3 daily volumes are expected to be approximately + or -8% of total volumes around the average. Exh. 1T, p. 13, ll. 7-9.)

3 This risk is real – not hypothetical, as Mr. D'Arienzo explained:

> . . . 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.

only takes one or two small little blips and I'm working for free, and that's not a good thing," as explained by Mr. D'Arienzo. (Tr. p. 404, l. 24 – p. 405, l. 8.)

24 Finally, the Company has explained the potential disadvantages associated with dealing with an unaffiliated third party in lieu of Avista Energy in its Initial Brief at pp. 45-46. While the Commission Staff's interest in having an "arms-length transaction" would be met, remaining issues of prudence and auditability may be greater with a third party. Moreover, the Company would be concerned about maintaining control and reliability of supply, which is possible through its relationship with Avista Energy, but may be less likely with an independent third party. As we have witnessed in the Industry, sometimes not even a well-drafted contract with a third party guarantees performance, if the party is unwilling or unable to perform. The overriding concern of Avista Corporation in natural gas procurement is providing reliable natural gas supply to its customers with pricing that reflects an appropriate balance of low cost and price stability. (Norwood Rebuttal, Exh. 3, p. 16, ll. 12 – p. 17, ll. 12).

II. STAFF ERRONEOUSLY CONCLUDES THAT THE MECHANISM REWARDS AVISTA ENERGY FOR AVERAGE PERFORMANCE

25 Beginning at page 17 of its Brief, Staff contends that, with respect to commodity, storage or transportation, Avista Energy can be rewarded for only average performance. In other words, Avista Energy is rewarded or penalized simply because of movements of the market, as opposed to its own efforts.

26 Leaving aside the theoretical question of whether, over time, it is even possible to "beat the market," the immediate question is whether the Utility could do as well, if it acted alone in managing its procurement function. With respect to commodity transactions, it should be recalled that Avista Energy provides expert guidance with respect to purchasing strategies for

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(Tr. p. 388, ll. 4-7.)

Tiers 1 and 2, including advice on hedging. There is no reason to believe that Avista Utilities, acting alone, and without the benefit of Avista Energy's market insights, could perform any better without the expert advice. Moreover, with respect to Tier 3 purchases, Avista Energy is "in the market" in a far more substantial way than is Avista Utilities. Simply put, Avista Utilities is not positioned as well as Avista Energy to take advantage of market opportunities when they arise. Moreover, with respect to storage, Avista Utilities, acting alone, could not do as well in taking advantage of opportunities as they arise. The same could be said of transportation. These matters were discussed at length in Avista's Initial Brief. In the final analysis, the advantage of the 80/20 sharing is that for every $1 earned by Avista Energy, Avista's customers realize $4 of benefits.

27 If from time to time Avista Energy does not "beat the market," it is not through want of trying or a lack of expertise. Indeed, as pointed out above, Avista Energy is bearing other risks relating to counter-parties, credit and delivery. Why not provide incentives to Avista Energy to parlay its market presence and skills for the benefit of our customers? In fact, to do otherwise, would be a missed opportunity.

28 In the final analysis, one either accepts the premise that ratepayers benefit from access to Avista Energy's market presence and skills or one doesn't. (And apparently Staff doesn't, even in the face of credible evidence.) If you do accept this premise, then it is a matter of designing a mechanism that appropriately captures the synergies of Avista Energy and Avista Corporation working together. That should be what the debate is over in this matter. If problems remain with the Mechanism, let's find a way to make it work. If, on the other hand, one does not accept the premise that Avista can benefit from Avista Energy's participation, then the Mechanism should be terminated and this matter concluded. For its part, Avista has encouraged constructive dialog

and has embraced changes to the Mechanism to be responsive to Staff's concerns. Having made numerous modifications and adapting the Mechanism to changed conditions, it would be unfortunate to abandon the Mechanism – especially in a time of increased volatility when customers would benefit from Avista Energy's involvement most.

III. STAFF'S CRITIQUE OF AVISTA ENERGY'S PARTICIPATION IN BASIN OPTIMIZATION IS MISPLACED

29 Beginning at page 25 of its Brief, Staff raises a "red herring" of sorts, with regard to Avista Energy's management of basin optimization on behalf of the Utility. In an unfortunate tone, Staff asserts that Avista Energy somehow "exploited" the Mechanism in 2002 when it realized approximately $4 million in basin optimization benefits. Staff then criticizes Avista for not challenging Avista Energy with respect to the benefits Avista Energy derived from basin optimization.

30 There are two basic flaws in Staff's critique. First of all, Staff is very selective, when it chooses to focus on only <u>one</u> element of many under the prior Mechanism. Mr. Norwood explained during cross examination why it was not unreasonable for Avista Energy to derive optimization benefits in the face of Avista Energy's substantial Tier 3 exposure. Avista Energy was absorbing a lot of risk in connection with Tier 3 daily volatility, and their "compensation for that was the opportunity to capture the basin optimization." (Tr. p. 150, ll. 1-4.) As further explained by Mr. Norwood:

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> . . . Under the arrangements that were in place during this time period, Avista Energy was actually covering the costs on what's referred to there [Exhibit 55-C] as the line three, peaking P&L, and under the same total column, you can see there's a negative $8.8 million. And so when you net those out, they receive the benefits from the basin optimization, but they absorb the costs from the peaking, and so when you net it out, there was a loss that has actually occurred to date with their management of the benchmark mechanism for them. And most of that was driven from the 2000 time frame.

32 (Tr. p. 196, l. 24 – p. 197, l. 10.) Staff simply chooses to ignore the $8.8 million of Tier 3 commodity costs that were otherwise absorbed by Avista Energy in 2000. In any event, it is undisputed that under the Mechanisms in place at the time, Avista Energy actually lost, on average, $1.1 million per year, even taking into account basin optimization. (See Bench Request No. 1.)

33 Irrespective of how this Basin optimization has been characterized by Staff and Public Counsel, the facts are that when the original Mechanism was implemented all the parties had an understanding that Avista Energy would provide the gas procurement services for the Utility under the Agency Agreement and in so doing would assume the risks involved with providing these services. In order to manage all the risks involved and the volatility associated with providing these services it was also understood that Avista Energy would manage the assets and share in the benefits. Avista Energy currently assumes the majority of the risk related to intra-month volatility and Basin Optimization is one way to mitigate the risks or cover the costs associated with this volatility, while assuming 100% of the risk for delivery. Furthermore, both parties recognized that there were risks as well as rewards associated with matching loads to assets.

34 The fact is that since the inception of the Mechanism in September 1999, Avista Energy has absorbed significantly more costs in covering daily load variability than the benefits it has received from Basin Optimization. (See Bench Request No. 1.) Staff acknowledged the costs absorbed by Avista Energy in recognizing that "Avista Energy lost a whopping $8.8 million" during November and December 2000. (Staff Initial Brief at p. 29 paragraph 95.)

35 Furthermore, not only did Avista Energy absorb the costs to cover loads during 2000 that would have otherwise been born by Avista Utilities' customers, Avista Energy captured

significant capacity release/off-system sales benefits of which over 90% were passed on to customers. Staff acknowledged in its Initial Brief that during the two months of November and December 2000, "Avista Energy reaped a $10.4 million windfall in off-system sales." (Staff Initial Brief p. 44, paragraph 151.) Although Staff has referred to these months as an "anomaly," the reality is that Avista Energy, through the Mechanism, provided Avista Utilities' customers with a significant "double benefit" during this period. One substantial benefit was absorbing $8.8 million to cover daily loads. A second substantial benefit was capturing over $10 million of transportation benefits, of which over 90% flowed through to customers. Regardless of how this time period is characterized, the reality is that the Mechanism has provided significant demonstrable benefits to Avista Utilities' customers. Avista Energy is uniquely positioned to provide risk/cost protection for customers (in areas such as credit, non-payment by counter parties, market liquidity, etc.) as well as to capture meaningful benefits for customers by taking advantage of the volatility of price differences between supply basins through off-system sales and basin optimization transactions, among other transactions.

36 The second flaw, which again explains why this is truly a "red herring," is that the proposed Mechanism which is at issue in this proceeding, has an 80/20 sharing of the benefits of basin optimization (unlike the current Mechanism, which Staff seems to be attacking). Mr. Norwood explained that the Company, in response to Staff's desire to capture the basin differential, provided for an 80/20 sharing of basin optimization benefits, but in so doing, also made that same 80/20 sharing applicable to Tier 3 transactions for daily load variability, in order to balance the risks and rewards. (Tr. p. 150, ll. 18-23.)

37 In fact, going forward, we would hope that Avista Energy would even surpass its past performance in the area of basin optimization, given the 80/20 sharing of benefits. For every $1

realized by Avista Energy in connection with basin optimization, ratepayers will benefit by $4. Furthermore, it is ironic that the 80/20 sharing of basin optimization benefits was the result of one of several refinements to the Mechanism suggested by Staff; now, instead of supporting the refined Mechanism, it chooses to critique the prior version of the Mechanism. Staff should, instead, be commenting on the proposed Mechanism now before this Commission.[4]

IV. THE MECHANISM DOES, IN FACT, COMPORT WITH THE COMMISSION'S POLICY STATEMENT ON INCENTIVE MECHANISMS

38 Staff, beginning at page 32 of its Brief, asserts that the Mechanism fails when measured against the Commission's 1997 Policy Statement (Docket No. UG-940778). Staff and Public Counsel (see pages 12-14 of Public Counsel's Brief) complain about the lack of "external benchmarks," it's auditability, and lack of symmetry.

39 Avista's Initial Brief (paragraphs 166-172) explained how the proposed Mechanism does conform with the Policy Statement. Exhibit 6, attached to Avista's Initial Brief described how each guiding principle within the Policy Statement was satisfied by the proposed Mechanism. There are, in fact, "external benchmarks" for each of the components. (See pages 54-55 of Avista's Initial Brief.) (In fact, Avista Energy compared its average daily purchases and sale prices with Gas Daily published indices for the year 2002 and found there was no significant variance between the two. (Exh. 3T, p. 12, ll. 3-15.))

40 Moreover, the Mechanism is easily auditable, as explained at pages 51-54 of Avista's Initial Brief. Tier 1 and Tier 2 purchases will be "tagged" for the Utility for ease of audit; Tier 3 daily volumes will be actual Utility volumes purchased and will be priced at the average daily price of all of Avista Energy's purchases for each day. Similarly, all storage transactions will be

[4] Even though Avista Energy lost $8.8 million with respect to commodity transactions in 2000, Mr. D'Arienzo testified that Avista Energy did not seek relief from Avista Corporation or otherwise attempt to modify the

easily "tagged" as being utility specific, and the same holds true with respect to transportation transactions. In order to further facilitate review, Avista proposed the creation of a "daily log" to assist the audit process, which incorporates external benchmark comparisons on a daily basis. (A sample daily log was attached to the Initial Brief as Appendix H.) This would supplement the quarterly reports already being provided to Commission Staff and interested parties. If Staff and Public Counsel have additional constructive suggestions to make, in order to facilitate their audits, Avista would welcome such a contribution.

41 Moreover, the incentives under the proposed Mechanism are symmetrical. There is an 80/20 sharing across each of the primary components, including Tier 3 commodity purchases, storage and transportation. In this manner, the decisions will not be biased in favor of any particular procurement strategy.

42 In the final analysis, the Policy Statement was meant to promote innovative thinking and not serve as a straightjacket.

V. QUANTIFICATION OF BENEFITS

43 Staff contends that ratepayers are not getting a "good deal." Staff asserts that the analysis ignores the fair market value of the use of Avista's storage, gas portfolio and transportation by Avista Energy. (Brief beginning at p. 35.)

44 In fact, it is the other way around. As explained in Avista's Initial Brief, Staff witness Parvinen has it backwards when he asserts that "access to these valuable assets provides economies of scale and market presence to Avista Energy." (Exh. 201T, p. 52, ll. 11-12.) Avista Utilities, in fact, is the one that benefits from the size and scope of Avista Energy's involvement in the natural gas markets. It is Avista Energy that actually provides Avista Utilities with "market presence," and customers receive the benefits of being part of a much larger natural gas

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Mechanism; instead, it fulfilled its end of the bargain. (Tr. p. 378, ll. 12-15.)

portfolio. (Avista Utilities' natural gas volumes managed by Avista Energy amounted to less than 3% of Avista Energy's total business.) (Exh. 3T, p. 3, ll. 8-13.)

45 In Paragraphs 130-133 on pp. 39 and 40 of Staff's Initial Brief, it discusses the treatment of the benefits that would accrue to Avista Energy under the proposed Mechanism related to the storage summer/winter differential, the peaking benefits of storage, and capacity release/off-system sales revenues. In Paragraph 133 Staff states that "the dollar impact of this issue is equal to 20% times the amounts shown on lines 4, 5, and 8 of Exhibit 209-C, for a total of $1,538,422.20." After further review of the analysis of benefits in response to Staff's Brief, the Company agrees with Staff's recommended adjustment of approximately $1.5 million. This adjustment would reduce the Company's calculation of the estimated annual benefits to Avista Utilities' customers from the Mechanism from $2.6 million to approximately $1.1 million per year. In this regard, Staff is right, and the Company is wrong.

46 Nevertheless, with respect to two of the largest components of the cost calculation – load volatility and transportation – Staff has made several fundamental errors which were discussed, in detail, in Avista's Initial Brief. Mr. Parvinen's assumption that there is absolutely no cost to cover daily load variability for the Utility is, on its face, simply unrealistic. As Mr. Parvinen acknowledged, his conclusion is based on his "judgment." It is not supported by sound analysis. For its part, the Company provided that analysis through the various "scenarios" discussed in Mr. D'Arienzo's rebuttal testimony, as discussed in the Company's Initial Brief. Furthermore, it is simply unrealistic to conclude that Avista Energy provides absolutely no additional value in its management of available pipeline transportation. Mr. D'Arienzo and Mr. Gruber, who between them have over 40 years of operating experience, have provided credible evidence to the contrary.

47 In the final analysis, however, the Commission should not let this Mechanism founder over a dispute concerning "quantification" of benefits which are in the range of $1.1 million to the positive for customers (Avista's view) or $1.6 million to the negative (Staff's view). While reasonable minds can differ, there has been a credible showing by Avista that there are positive benefits of some magnitude. Moreover, this "quantification" process does not even begin to capture the other risks being absorbed by Avista Energy that would otherwise be shouldered by Avista's customers: e.g., counter-party risk, and the risk of non-delivery of supplies.

VI. CONCLUSION

48 If one accepts the premise that there are benefits to be derived by Avista's customers through Avista Energy's greater market presence and expertise, then there is justification for the continuation of this Mechanism. It has proven to be an adaptable Mechanism given changed market conditions. In fact, it is arguably more important now than ever before, given increased market volatility and the risks that that entails. Why not take advantage of Avista Energy's attributes. If there is additional fine-tuning that needs to be accomplished, so be it. Avista has proven receptive in the past to such improvements and remains so today. In short, the public interest will be served by a continuation of this Mechanism.

RESPECTFULLY SUBMITTED this 9th day of January, 2004.

AVISTA CORPORATION

By: ______________________
David J. Meyer
Senior Vice President and General Counsel

CERTIFICATE OF SERVICE

I hereby certify that I have served the Reply Brief of Avista Corporation upon all parties of record in Docket No. UG-021584, by commercial parcel delivery company properly tendered with fees prepaid.

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Dated at Spokane, Washington this 9th day of January 2004.

Patty Olsness
Rates Coordinator