Avista Utilities
Transition Plan for Benchmark Mechanism

Introduction:

1. Under the proposed Transition Plan, the Natural Gas Benchmark Mechanism (Benchmark Mechanism) and Schedule 163 would terminate effective April 30, 2004. For accounting purposes it will be important to terminate at the end of a calendar month.

2. With regard to the Transition Plan, the Commission stated in its Order at paragraph 89 that:

   > "… it acknowledges the Idaho and Oregon arrangements, leaving room for discussions of parties that develop a transition that coordinates with other Avista operations and provides the least disruption to the company and its ratepayers."

   In addition, the Commission stated at paragraph 91 and again at paragraph 111:

   > "In developing the schedule for transition, the parties may consider that the Mechanism as it currently exists in Oregon and Idaho expires in March 2005. The Commission will consider a further extension of the expiration date, if necessary, depending on the plan we approve for transition of the Mechanism."

3. Recognizing that the Transition Plan should be one that "provides the least disruption to the company and its ratepayers," the proposed Plan would terminate the Benchmark Mechanism in Washington in the near-term, while attempting to avoid the inefficiencies during the Transition Period associated with having part of the procurement functions at Avista Energy (Idaho and Oregon) and part of the functions at Avista Utilities (Washington). To illustrate this point:

   a. With regard to transportation (especially), if the execution of transactions were to be immediately transferred back to the utility, the utility does not yet have trained staff in place, nor does the utility have adequate counterparty contacts to properly optimize available pipeline transportation through capacity releases and off-system sales. The proposed Transition Period would provide time to hire additional staff and train them, so that they would be fully prepared to begin execution at the end of the Transition Period.

   b. The staff positions necessary to perform the natural gas procurement functions require highly trained individuals with respect to the natural gas commodity markets, pipeline transportation systems, the utility's specific system, available storage facilities and related requirements, and the utility's retail loads for each season of the year, among other things. It will likely take a minimum of several months to identify, interview and hire these individuals, and additional months to train them on Avista's system and load characteristics. During the Transition Period one or more of the utilities' employees would be located with Avista Energy in order to train them in the operations and prepare them for the April 1, 2005 transfer.

c. The transportation assets and supply portfolio are operated as a pool to gain efficiencies. If the Washington operations are separated from the Idaho/Oregon operations, it would result in inefficiencies and increased costs to customers. For example, the demand diversity across Avista's whole system allows the Company to project a system peak day that is lower than the sum of the design peak in each state, because the peak day does not occur on a coincident basis. As a second example, the pipelines allow the Company to consolidate system imbalances for all states.

Details of Proposed Transition Plan:

4. Termination of Schedule 163 and the Benchmark Mechanism: The current Benchmark Mechanism and Schedule 163 would terminate effective April 30, 2004. The proposed Transition Period would be May 1, 2004 through March 31, 2005. During the proposed Transition Period, the Utility would continue to consult with and draw on the expertise of Avista Energy, however, the management and decision-making related to the natural gas procurement functions would reside with Avista Utilities, under the Manager of Gas Supply. The execution of transactions would be conducted by Avista Energy. There would be no incentive-sharing (i.e., 80%/20%). All costs and benefits associated with commodity, Jackson Prairie (JP) Storage, transportation and basin optimization would go to Avista Utilities' customers. Avista Energy would only receive a management fee to cover a portion of the costs it occurs in providing this service during the Transition Period, as set forth below.

5. Incentive Sharing Eliminated: No Sharing of costs or benefits by Avista Energy, including:

   a. No sharing of benefits associated with:
      i. Commodity transactions, including basin optimization;
      ii. Storage summer/winter differential; and
      iii. Transportation – Capacity Release/Off-System Sales.

   b. No sharing of costs associated with:
      i. Intra-month load and price volatility; and
      ii. Miscellaneous risks, e.g., currency, premium for physical delivery, nomination errors, counter-party risk, operational flow orders or entitlement.

6. Commodity: Under Avista Utilities' direction, Avista Energy would purchase a portion of the Utilities' natural gas requirements months in advance, some at first of month (FOM) index, along with daily purchases and sales (including basin optimization) and the use of storage to balance load. The decision to use storage to cover load versus purchasing from the daily market would be made by Avista

Utilities. All costs and benefits associated with the commodity costs to serve the utility's load, including basin optimization, would be billed or credited to utility customers.

7. Storage: Under Avista Utilities' direction, Avista Energy would inject and withdraw storage providing the winter/summer price differential and reliability of peak day demand coverage. All costs and benefits associated with the storage transactions would be billed or credited to utility customers.

8. Transportation: Under Avista Utilities' direction, Avista Energy would optimize available pipeline transportation through capacity releases and off-system sales. All costs and benefits associated with these transactions would be billed or credited to utility customers.

9. Management Fee: Avista Utilities would pay Avista Energy a management fee of $75,000 per month during the Transition Period for the services provided, which would be included in the PGA costs. The purpose of the fee would be to compensate Avista Energy for a portion of their costs such as employee labor and associated support costs and credit and banking costs, as shown in the table on Page 32 of the Commission's Sixth Supplemental Order.

10. Training/Misc.: During the transition period, Avista Utilities would complete the tasks necessary to bring the gas procurement functions back within the utility, i.e. hiring and training of employees, pipeline, storage and third party supplier notifications of change in contract relationships, development and documentation of internal administrative procedures, etc.

11. Other Jurisdictions: The Benchmark Mechanism terminates in Idaho and Oregon March 31, 2005. Effective April 1, 2005 execution of natural gas procurement services for all three states (Washington, Idaho and Oregon) would revert to the utility.