

Docket Nos. UE-011595 & UE-030751
Avista ERM Prudence Review
Non-Confidential Supplemental
Testimony of Catherine M. Elder
Exhibit _____ CME-ST

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET No. UE-011595 & UE-030751

SUPPLEMENTAL TESTIMONY OF CATHERINE M. ELDER (CME-ST)

ON BEHALF OF

PUBLIC COUNSEL and

SPOKANE NEIGHBORHOOD ACTION PROGRAMS and

CITIZENS' UTILITY ALLIANCE OF WASHINGTON

December 2, 2003

1 **Q: Please summarize this supplemental testimony.**

2 **A:** This testimony describes findings resulting from review of additional data Public Counsel and
3 SNAP obtained on or about October 8, 2003, after Avista filed its rebuttal testimony on
4 September 17, 2003. In general, we present detailed evidence confirming that Avista seems to
5 have had no overriding strategy or guidelines for determining when to sell its out-of-market
6 natural gas. There were many days for which the transactions Avista conducted were
7 economic, but Avista has failed to explain why it chose the dates that it did to execute the
8 transactions. Had Avista chosen to execute these transactions on different days, it could on
9 average, have obtained \$1.1 million (WA portion) more in revenue savings than it did.

10 Accordingly, I recommend Avista be held accountable for the potential savings it failed to
11 achieve (i.e., that recovery of the \$1.1 million plus associated interest be disallowed). Also, I
12 recommend that the Commission require Avista to develop a more coherent and explicit set of
13 policy guidelines for making such sales in the future. In light of the fact that costs associated
14 with the out-of-market gas, \$14.7M, represent about 60% of the costs booked to the ERM
15 deferral, it is entirely reasonable and appropriate for the Commission to require Avista to
16 provide much more of an explanation with respect to its strategy and decision making in
17 managing power supply costs. See Attachment A to Avista's March 28, 2003 filing to review
18 deferrals.

19 **Q: Why are you filing supplemental testimony?**

20 **A:** On behalf of Public Counsel and SNAP I expressed substantial concern in my initial direct

1 testimony as to how Avista chose whether and when to sell its natural gas, and whether in
2 making those sales Avista should have sought to obtain more revenue to use in offsetting the loss
3 to ratepayers from having to sell high-priced gas into a low-priced market. The rebuttal
4 testimony of Avista witness Mr. Storro contained data that to date had not been provided to the
5 parties to this proceeding despite extensive discovery. RLS-3 at pages 1-3.

6 **Q: What data did you obtain?**

7 **A:** Specifically, the data consists of Avista's daily Position Reports emails for every business day in
8 2002, provided by the company in response to DR PC-170.¹ These emails contain forward gas
9 and power prices Avista had available to analyze in order to decide whether it was more
10 economic for Avista to use market-priced gas to generate electricity, or whether Avista should
11 instead sell its gas and buy replacement power, if needed.

12 **Q: Why is this data important?**

13 **A:** As I explained in my initial testimony (Exhibit CME-1TC at page 6, lines 3 – 17), Avista
14 Witness Storro indicated in his direct testimony (Exhibit RLS-T, pp. 6 – 8) that Avista looked
15 at the market every day in order to determine when it was economic to sell gas and purchase
16 replacement power. In response to repeated data requests to Avista, Avista had offered only
17 its economic analysis for the specific eighteen days that the 23 transactions were executed as the
18 basis for its decisions to sell gas and purchase replacement power. (See, for example, Exhibits

¹ In response to DR PC-170, Avista provided Position Report e-mails for 253 business days in 2002. These e-mails include data concerning forward gas and power prices. Business days are Monday – Friday, excluding holidays. The Position Report e-mail for Thursday, June 13, 2002, was not included in Avista's response to DR PC-170.

1 CME-4 and CME-5). As indicated in my initial testimony, Public Counsel and SNAP are
2 interested in evaluating how Avista selected the days on which to execute those transactions.
3 (Exhibit CME-1TC, p. 3, ll. 8–17; and p. 8, l. 12 to p. 9, l. 10; and p. 11, l. 4 to p. 13, l. 20).
4 We believe it is not enough for the transactions to have been economic on the particular days
5 Avista chose to execute the transactions – the fact that they were economic to some degree on
6 those particular eighteen days does not, by itself, necessarily make them “reasonable.”
7 Specifically, Avista knew it had a net fuel expense it would need to recover in its deferral
8 account owing to the fact that natural gas market prices dropped substantially from the time it
9 bought the gas to the record period. Public Counsel and SNAP instead think Avista should
10 have some obligation to try to mitigate that expense.

11 In particular, Avista is a sophisticated market player with access to information about
12 future prices, cash and forward price trends, market assessments, and Avista interacts with
13 numerous counter-parties to exchange and test that information daily. Avista also knew that
14 with the drop in market prices for natural gas, the unrecovered fuel expense would be
15 recovered in the deferral account. Therefore, it seems reasonable to expect, at a minimum, to
16 see evidence that Avista had an overarching strategy or framework in place to evaluate how it
17 should mitigate the loss to ratepayers associated with the out-of-market gas the company held.
18 To date, however, Avista has provided no such evidence. Rather, Avista seems to have
19 handled the transactions as a routine trading matter in which it matters only that the specific
20 transactions it executed were economic to some degree, on the days Avista happened to

1 execute the transactions. On behalf of Public Counsel and SNAP, I instead suggest that
2 ratepayers deserve more.

3 **Q: What does Avista’s response to DR PC-170 show?**

4 **A:** The Position Reports emails, which Avista has designated confidential, show **[Begin**

5 **Confidential]** *****

6 *****

7 *****

8 *******[End Confidential].**

9 **Q: Have you performed an analysis using this additional data that would cause you to**
10 **revise your earlier analysis?**

11 **A:** Yes, I have. At page 3, line 14, of my initial testimony, CME-1TC, I recommended the
12 Commission disallow the entire \$14.7 million “net fuel expense not included in Account 547” as
13 reflected at line 7 in Appendix A to Avista’s original March 28, 2003 filing, on the grounds that
14 Avista had not justified the expense.

15 **Q: Does the additional data provided by Avista in response to DR PC-170 justify the**
16 **\$14.7M expense associated with the out-of-market gas sales?**

17 **A.** No, it does not. But as a result of my analysis, I believe that at a minimum the Commission
18 should disallow \$1.06M (WA portion) plus associated interest from the ERM deferral account
19 for the review period. Thus, I am revising my recommendation that the Commission disallow
20 the entire \$14.7M.

1 **Q: Please describe the analysis you conducted using the additional data from Avista.**

2 **A:** I reviewed the power and gas prices shown on each day's position report email provided in DR
3 PC-170 and compared the **[Begin Confidential]** ***** **[End**

4 **Confidential]** reported there against Avista's calculated **[Begin Confidential]** ***

5 ***** **[End Confidential]** also shown in the position

6 report email.² This allowed me to look at the differential between the **[Begin Confidential]**

7 ***** **[End Confidential]** versus the **[Begin**

8 **Confidential]** ***** **[End Confidential]** on each day that

9 Avista sold gas and purchased power. For example, as shown in Table 1 below, looking at the

10 Position Report email for April 3, 2002, a day on which Avista sold 5,000 MMBtu of July gas,

11 Avista shows **[Begin Confidential]**

12 *****

13 *****

14 *****³ **[End Confidential]** DR PC-170. Avista's

15 response to DR PC-170 shows the **[Begin Confidential]**

16 *****

17 *****

²Note: We have calculated this differential only for heavy load hours, due to time constraints and the fact that most of the transactions are for heavy load hours. Prices are lower in light load hours, making it less economic to sell the gas and buy cheaper replacement power when needed.

³**[Begin Confidential]** *****

***** **[End Confidential]**.

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1 *****

2 *****

3 **[End Confidential].**

4 **[Begin Confidential]**

5 *****

6 *****

7 *****

8 *****

9 *****

10 ***** **[End Confidential]**

11 Table 2, below, shows the difference between **[Begin Confidential]** *****

12 ***** **[End**

13 **Confidential]** actually achieved by Avista in executing each of the 23 transactions. A positive

14 number means **[Begin Confidential]** *****

15 *****⁴ The results in Table 2,

16 **[Begin Confidential]** *****

17 *****

⁴ **[Begin Confidential]** *****
***** **[EndConfidential]** While Avista can create savings for ratepayers by selling its gas and buying replacement power in the market, it still has to recover in the deferral account the difference between the purchase price of the gas and the market price it obtained on sale. The sales price for the gas bears directly on how much of this latter amount remains unrecovered. What we have tried to determine is whether Avista exercised due diligence to try to reduce the amount left in the deferral account.

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1
2

***** [End Confidential].

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1 **[Begin Confidential]** *****

2 *****

Line No.		Jul	Aug	Sep	Oct	Nov	Dec
1	8-Jan-02	**					
2	3-Apr-02	***					
3	4-Apr-02					****	****
4	5-Apr-02	****				***	****
5	17-May-02	****	****	****	****		
6	21-May-02		****	****	****	****	
7	22-May-02			****	****		
8	23-May-02				****	****	****
9	28-May-02				****		
10	5-Jun-02						****
11	19-Jun-02	****					
12	20-Jun-02					****	****
13	15-Jul-02		****	****			
14	13-Aug-02			****			
15	10-Sep-02				****		
16	17-Sep-02						****
17	1-Oct-02				****	***	
18	20-Nov-02						*****

3 **[End Confidential]**

4 Then, I further assessed the data contained in the daily position report emails in DR PC-

5 170 to calculate**[Begin Confidential]** *****

6 *****

7 *****

8 *****

9 *****

10 *****

11 *****

1 **[End Confidential]**. These results are shown in Table 3.

2 **Table 3. [Begin Confidential]** *****
 3 *****

Line No.		Jul	Aug	Sep	Oct	Nov	Dec
1	8-Jan-02	**					
2	3-Apr-02	**					
3	4-Apr-02					**	**
4	5-Apr-02	**				**	**
5	17-May-02	**	**	**	**		
6	21-May-02		**	**	**	**	
7	22-May-02			**	**		
8	23-May-02				**	***	***
9	28-May-02				**		
10	5-Jun-02						***
11	19-Jun-02	**					
12	20-Jun-02					****	***
13	15-Jul-02		*	**			
14	13-Aug-02			*			
15	10-Sep-02				***		
16	17-Sep-02						**
17	1-Oct-02				**	**	
18	20-Nov-02						*

4 **End Confidential]**

5 For example, looking at Line No. 4 of Table 3, for the April 5 sale of 15,000 MMBtu
 6 of gas for the month of July 2002, Table 3 shows that there were **[Begin Confidential]**

7 *****
 8 *****
 9 *****
 10 *****

11 **[End Confidential]** Avista could have achieved more savings, which would result in decreased

1 costs to the ERM deferral account. In another example, as shown at Line No. 12; **[Begin**

2 **Confidential]** *****

3 *****

4 *****

5 ***** **[End Confidential]**.⁵ DR PC-170.

6 In short, the data in Avista’s response to DR PC-170 shows that there were **[Begin**

7 **Confidential]** *****

8 *****

9 ***** **[End Confidential]**.⁶ But what we still do not have is any justification

10 from Avista for how it chose the specific days on which to execute the transactions.

11 **Q: Have you calculated a total value for the additional improvement Avista could have**
12 **reasonably been expected to achieve?**

13 **A:** Yes, I have. Keep in mind that this value represents how much better Avista could have done,
14 on average, over the days on which **[Begin Confidential]** *****

15 *****

16 *****

⁵ Data for Thursday, June 13, 2002 was not included in Avista’s response to DR PC-170 and thus was excluded from this analysis.

⁶ It is important to note that this analysis assumes that Rathdrum is the marginal available generating unit. Had Coyote Springs II been available during the ERM review period, the analysis would be much different due to the more efficient heat rate of CS2. I recommended in CME-1TC, pages 19-20, and CME-11C that if the Commission determines that costs associated with the delays of the availability of Coyote Springs II should not be booked to the ERM deferral account, that it should disallow **[Begin Confidential]** ***** **[End Confidential]** of net fuel expenses. This supplemental testimony does not change that recommendation.

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1 *****

2 *****

3 ***** [End Confidential]. Avista bought

4 the gas initially to generate electricity at Coyote Springs II. And even if Avista does not need

5 the gas to generate electricity for itself, Avista's analysis [Begin Confidential]

6 *****

7 *****

8 *****

9 ***** [End Confidential]

10 **Q: Please explain how you performed this calculation.**

11 **A:** I calculated the increase in benefit available between [Begin Confidential] *****

12 *****

13 *****

14 ***** [End Confidential] For the April 5, 2002 sale of

15 15,000 MMBtu in July (Line No. 4 of Table 4 below), the average increase in benefit available

16 [Begin Confidential] *****

17 *****

18 *****

19 *****

20 *****

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1 *****

2 ***** **[End Confidential]**.

3

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1 **Table 4. [Begin Confidential] *******

Line No.		Jul	Aug	Sep	Oct	Nov	Dec
1	8-Jan-02	****					
2	3-Apr-02	****					
3	4-Apr-02					****	****
4	5-Apr-02	****				****	****
5	17-May-02	***	****	****	****		
6	21-May-02		****	****	****	****	
7	22-May-02			****	****		
8	23-May-02				****	****	****
9	28-May-02				****		
10	5-Jun-02						****
11	19-Jun-02	****					
12	20-Jun-02					****	****
13	15-Jul-02		****	****			
14	13-Aug-02			****			
15	10-Sep-02				****		
16	17-Sep-02						****
17	1-Oct-02				****	****	
18	20-Nov-02						****
19							
20	Wtg Average	****	****	****	****	****	****

2 **End Confidential]**

3 Table 5 shows the translation of the Table 4 results of available improvements into total
 4 dollars. I took the average improvement in the **[Begin Confidential] *******

5 *****

6 ***** **[End Confidential]** The result is shown at Line No. 1 of Table 5. Then I

7 multiplied times the number of Mwh Avista could have generated with the 40,000 MMBtu for

8 that month: 40,000 MMBtu of gas multiplied by a heat rate of **[Begin Confidential]**

9 *******[End Confidential]** Mwh per day, times the number of days in each

10 month. The result is shown at Line No. 2. Line No. 3 shows the product of Line No. 2

1 multiplied by Line No.1. Adding the months together results in a total recommended
 2 disallowance of \$1.6 million (system basis), representing the average amount Avista failed to
 3 achieve by selling on the days it selected.

4 **Table 5: Total Value of Improvement Available to Avista**

Line No.		July	August	September	October	November	December	Total
1	[Begin Confidential] *****	****	****	****	****	****	****	
2	****	*****	*****	*****	*****	*****	*****	
3	*	*****	*****	*****	*****	*****	*****	1,601,004
4	WA (66.29%)	*****	*****	*****	*****	*****	*****	1,061,306

5 **[End Confidential]**

6 **Q: But did Avista replace the MWhs it could have generated with the entire 40,000**
 7 **MMBtu each month?**

8 **A:** No, in fact, Avista did not replace the entire number of MWhs that it could have generated with
 9 the 40,000 MMBtu per day for each month. According to our review of RLS-2, Avista
 10 replaced 25 aMWs for July, 175 aMWs for August, 125 for September, 225 for October, 125
 11 for November and 100 for December. (Note that if Rathdrum really is the unit available for
 12 generation, Avista was “short” relative to the approximately 150 aMWs that Rathdrum could
 13 generate using the 40,000 MMBtu per day. So if it was going to generate those same aMWs
 14 as it ended up needing, Avista would have needed to purchase more gas for August and for
 15 October, or otherwise remedy its apparent short position for those months).

16 **Q: Why should the disallowance refer to the entire MWhs that could have been generated**
 17 **with the 40,000 MMBtu per day?**

1 **A:** Because all of the gas was disposed of on a joint transaction basis, looking at the [**Begin**
2 **Confidential**] *****
3 ***** [**End Confidential**] Avista recognized that even if it were in a long position on power, it
4 should still compare the cost of what it could generate using its 40,000 MMBtu to see if it was
5 economic to burn the gas and sell the excess power. If so, the extra revenue would help reduce
6 the ERM deferral balance. Thus, the right comparison is to the MWhs that could be generated
7 using all 40,000 MMBtu per day.

8 **Q:** **In saying that there were “better” days on which Avista could have executed these**
9 **transactions, are you saying that Avista should have executed these transactions on**
10 **the days that offered the highest differential observed between the market price of**
11 **power and the calculated thermal cost of generation at Rathdrum?**

12 **A:** No, not at all. To make that argument would require Avista to have perfect foresight – which
13 no one can have. Instead, what I am pointing out is that it turns out that there were a lot of days
14 on which Avista could have done better than it did. We still have no analysis or documentation
15 from Avista as to how it picked the days it chose to execute these transactions. As cited
16 previously, they say that the transactions were executed when it was economic to do so. But
17 there were a lot of days on which it was economic to do so, and we know now that many of
18 those days were more economic than the days Avista chose. So the question remains: how did
19 Avista select the days for executing these transactions?

20 **Q:** **On a similar note, are you saying that Avista should have had perfect foresight of gas**

1 **and power prices in executing these transactions?**

2 **A:** No, I am not saying that, either. I am just saying there should be some methodology for
3 choosing which days to transaction other than “The market says selling gas and buying power
4 for month y is economic today. Let’s make a deal.” There should be embodied in the
5 decision-making process some notion of market trends and that decision-making process
6 should be better documented.

7 Also note that DRs PC 179 and 180 (attached as Exhibits CME-12 and CME-13,
8 respectively) asked Avista who approved the transactions and for copies of the documenting
9 decision memoranda. There apparently are none. Purchases of certain terms require
10 submission of a Cash Approval Request, which is a relatively *pro forma* document that doesn’t
11 address whether another day could be better to execute the transaction. Other transactions are
12 approved verbally. We have no way of knowing what those verbal discussions covered. We
13 also asked who approved the transactions. The answer is a list of individuals that “*may* have
14 been involved (emphasis added).” With all due respect, to recover a deferral balance of nearly
15 \$15 million incurred in a mere six-month record period, this Commission and the ratepayers it
16 protects deserve more.

17 **Q: When Avista says that it planned to sell out of its long position little by little does that**
18 **explain the pattern of transactions?**

19 **A:** No. Some of the transactions are jumbled together on consecutive days, some are not. I do

1 not see a little by little pattern evolve cogently.⁷ And for that to be a reasonable strategy, I still
2 must ask if there were given levels of losses deemed acceptable in laying off the excess gas over
3 time? How did that get determined? Why were large blocks for August and September left to
4 be sold in July and August instead of spread out over a longer period?

5 The overwhelming conclusion I have reached in analyzing Avista’s approach to
6 documenting these transactions is that Avista executed the transactions on days that “happened”
7 to be economic to some degree. For example, consider the May 17, 2002 transaction to sell
8 some of the August gas. Avista sold that gas **[Begin Confidential]** ***

9 *****

10 *****

11 *****

12 *****

13 *****

14 ***** **[End Confidential]**. Thus the question: why did Avista wait to sell this 5,000

15 MMBtu until May 17? What strategy or analysis led it to wait?⁸ A review of the transactions

16 for October gas, executed between May 17 and May 28, 2002, raises the same questions.

17 Why were so many transactions conducted in such a short time period when forward prices for

⁷In the response to DR PC-181, Avista indicates that its “strategy” was to sell the gas through a portfolio approach over a period of time, tending to average its way out of its gas position by entering into several transactions to sell gas for any given month. See also RLS-T (Storro Rebuttal), page 4, line 19-22.

⁸DRs WUTC-179 and 180 asked Avista to provide a narrative description on the timing of the gas sales. Avista replied with the economic details only of the specific transactions executed, and did not provide any description as to how the timing of the transactions was determined. See also, Exhibits CME-4 and CME-5.

1 the fourth quarter showed sales to be highly economic all the way back to January?

2 **Q: Were there also days on which Avista could have done worse than it did?**

3 **A:** Yes, there were.

4 **Q: Would it be appropriate to include those days in your analysis?**

5 **A:** No, it would not be appropriate to include the days on which Avista could have done worse in
6 the market.

7 **Q: Please explain why not.**

8 **A:** I will not dispute that Avista could have done a worse job. But for Avista to claim that it should
9 be judged on how much worse they could have done in addition to how much better reinforces
10 my point: that Avista does not appear to have a strategy or framework in place to determine
11 when the company should execute transactions in order to minimize net power supply costs.
12 For the worse days to be chosen, Avista must admit that it had no way of determining which
13 days would be better and which days would be worse. At that point, Avista may as well have
14 executed these transactions at random.

15 **Q: Please conclude your testimony.**

16 **A:** The question Public Counsel and SNAP are putting before the Commission is whether Avista
17 should have done a better job. The individual transactions to sell gas and buy power were
18 economic, save for one. But after extensive discovery and sorting through a lot of detail behind
19 each transaction, what remains missing is a broader strategy or framework for deciding when to
20 execute the transactions. Was it truly reasonable for Avista to have very little rationale for

1 choosing the specific days for executing these transactions? Is Avista's only responsibility to
2 make sure that the specific trades it executes are economic on the days executed? Or does
3 Avista, knowing that the gas underlying these transactions is already woefully out of market and
4 that ratepayers must pick up that loss, have an obligation to try to get ratepayers a better
5 outcome? I respectfully recommend the latter.

6 To put it a different way: Our review shows that Avista managed to engage in
7 transactions that benefited ratepayers, but that more benefits were achievable. We cannot tell if
8 Avista obtained the benefits it did by luck or by design. Logic suggests that design would
9 produce greater benefits (i.e., a lower ERM deferral balance). The Commission should order
10 Avista to produce a more coherent and documented strategy when it faces large market losses
11 such as the ones that create the large net fuel expense at issue in this proceeding.

12 Accordingly, I recommend a disallowance of \$1.6 million (on a system basis, \$1.06M
13 on a WA share basis, plus associated interest), the average amount by which Avista could have
14 done better had it some methodology for choosing when to transact rather than doing it "any"
15 day on which it was economic to some degree. Additionally, I recommend the Commission
16 direct Avista to develop a specific strategy to guide closing out of "long" positions that are
17 known to be "out-of-market," which will otherwise create large ERM deferral balances.
18 Lastly, the Commission should be very clear in directing Avista to provide in future ERM
19 deferral requests, a detailed showing documenting its decision process on associated
20 transactions in its direct case. The larger the amount to be recovered in the deferral account,

1 the more detailed Avista's showing should be.