

**AVISTA CORP.
RESPONSE TO REQUEST FOR INFORMATION**

JURISDICTION:	WASHINGTON	DATE PREPARED:	11/08/2010
CASE NO:	UE-100467 & UG-100468	WITNESS:	N/A
REQUESTER:	Bench	RESPONDER:	Kelly Norwood
TYPE:	Bench Request	DEPT:	State & Federal Regulation
REQUEST NO.:	Bench Request No. 1	TELEPHONE:	(509) 495-4267
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REQUEST:

Bench Request No. 1: Please rerun the model(s) used to generate Appendix 2 with the following three changes updating:

- the annual average natural gas price based on the most recently available 3-month average of 2011 forward prices;
- the most current Mid C flat electric price; and
- the Short-Term Contracts entered into by the Company as of November 1, 2010.

Please provide an updated spreadsheet reflecting the results as an “Updated Appendix 2”.

RESPONSE:

Avista has rerun the power supply model and other necessary analysis to reflect the three changes identified above in Bench Request 1 to the power supply numbers agreed to by all Parties in the Settlement Stipulation. The “Updated Appendix 2” is attached as Attachment 1. The original Appendix 2 to the Settlement Stipulation is also attached as Attachment 2 for ease of reference. The average wholesale natural gas price and average wholesale electric price (Mid C flat price) reflected in the Settlement Stipulation are \$5.13/Decatherm, and \$41.32/MWh, respectively. The updated natural gas and electric prices are \$4.24/Decatherm and \$34.19/MWh, respectively.

A comparison of the two appendices shows a total net power supply cost change (reduction in net costs) from the three changes of \$2.55 million on a system basis. The Washington jurisdictional share, at 64.87%, would be \$1.65 million. As was pointed out by both Mr. Norwood and Mr. Schoenbeck at the November 2nd hearing, Avista has already hedged a major portion of its open positions for 2011. Under its hedging program, that has been in place for many years, the Company closes more and more of its open positions as it nears the time to serve load in order to limit the impact that volatile market conditions can have on the costs to serve customers. At this point in time, the Company has essentially hedged 91% of its load for 2011. It is also important to note that some of the remaining open positions are surplus positions, and some are deficit positions. While a reduction in natural gas and electric prices would provide a benefit related to the deficit positions (i.e., being able to buy at a lower price), the lower prices would have the opposite effect on the surplus positions (i.e., the surplus would be sold at a lower price resulting in a lower benefit). Therefore, the reduction in prices cuts both ways depending on whether the Company is in a surplus or deficit condition in a given month.

Also, per the Bench Request, Attachment 3 includes the “ERM Authorized Level of Expense” for December 2010, both as proposed by the Parties in the Settlement Stipulation and with the three requested changes. Attachment 3 shows a net reduction in power supply expenses, from the three adjustments, of \$1.28 million on a system basis, or \$0.83 million Washington share.

There are a number of reasons why it is important to not make the changes identified in Bench Request 1 to Appendix 2, or to the Settlement Stipulation itself:

1. With regard to potentially lower power supply costs, the ERM is designed to provide benefits to customers if actual net power supply costs, following a rate case, are substantially lower than those included in the rate case, i.e., once the amount of a reduction in costs during a calendar year exceeds the \$4.0 million deadband, the major portion of any further differences are deferred and would be rebated to customers (75% to customers for differences between \$4.0 million and \$10.0 million, and 90% to customers for differences that exceed \$10.0 million). Therefore, the ERM is designed to protect customers and provide benefits to customers for major differences between actual power supply costs and those included in the rate case. It is important to note that when actual power costs are lower than those in the rate case, the first sharing band is 75% of the benefits to customers and 25% to the Company. However, when actual power supply costs are higher than those in the rate case, the first sharing band is 50% of the additional costs to customers and 50% to the Company. Therefore, the ERM is already designed to provide benefits to customers through the asymmetrical sharing bands when actual costs are lower than those in the rate case.
2. If Appendix 2 were to be updated to reflect the three changes, it would actually reduce the opportunity for customers to receive benefits through the ERM during 2011 from lower gas prices, as well as other changes that affect power supply costs. For example, Appendix 2 from the Stipulation includes net power supply expense of \$180,995,334 (line 5). If actual power supply expense in 2011 is lower than \$180,995,334, customers will begin to receive benefits through the 75% sharing band (described in 1. above) when the difference exceeds the \$4.0 million deadband (WA share). If the base power supply costs in Appendix 2 were to be updated using the three adjustments from Bench Request 1 to a lower number (\$178,449,716), the actual reduction in power supply costs during 2011 would need to be greater before customers would begin to receive benefits.
3. All Parties to this case sponsored Joint Testimony supporting the Settlement Agreement as a fair and reasonable resolution of all issues in the case and providing a balancing of interests for all parties, including the Company’s customers. In the Settlement, the Parties represented that they have:

. . . [n]egotiated this Settlement Stipulation as an integrated document. Accordingly, the Parties recommend that the Commission adopt this Settlement Agreement in its entirety.
(Exhibit JT-2, p.22, para.26)

The Parties to the case in areas that covered power supply costs in particular, arrived at the Settlement with the full knowledge that actual power supply costs for 2011 may be higher or lower than those agreed to in the Settlement due to a number of major factors that drive power supply costs. These include, among other things, changes in wholesale electric and natural gas prices, changes in hydroelectric conditions, availability of thermal plants, and changes in retail load. Any one or a combination of these factors could easily cause power supply costs during 2011 to be higher or lower than those included in the Settlement Stipulation.

Specifically, in the Joint Testimony filed in support of the Stipulation (see Exh. JT-IT), ICNU stressed the importance of arriving at a level of certainty around power supply costs through the settlement process (Id., at p.38):

The amount of costs related to power supply is always critical to ICNU, as these costs represent the vast majority of the rate charges paid by our members. The Settlement Stipulation represents a substantial reduction from the Company's filed power supply costs, which results from many adjustments, including updating gas costs and test period load levels. In addition, the parties have agreed to "lock-in" these costs giving ICNU members, as well as other customers, price certainty (an upper bound) at a time when budgets are being prepared for the coming year. All of these factors were crucial for ICNU, and therefore, ICNU supports the settlement on power costs. (emphasis supplied)

Mr. Schoenbeck, on behalf of ICNU, reiterated this point at time of hearing, stressing the need for certainty with respect to establishing a natural gas fuel price for power supply purposes. (TR. p.157, ll.20-24)

4. From Avista's perspective, the Company made concessions on non-power supply issues that took into consideration all components of the bargained-for settlement package, including the \$5.13/Decatherm natural gas price. In particular, the Company agreed to absorb all Lancaster costs in 2010 in excess of \$6.8 million, a stay-out period through April 1, 2011, reduced revenue related to capital additions by \$7.8 million, reduced recovery of Information Services expenses of \$1.2 million, reduced Vegetation Management expenses of \$1.1 million, as well as other reductions in expenses and rate base reflected on Table 1, page 3, of the Settlement Stipulation. Commission Staff noted a number of these and other concessions in their Statement in the Joint Testimony (Exhibit JT-1T) supporting the Stipulation:

Staff believes the all-party Settlement Stipulation addresses the requirement that the rates be fair, just, reasonable and sufficient. In addition to the issues addressed above, the all-party Settlement Stipulation addresses several revenue requirement issues of importance to Staff. In particular, it makes significant reductions, in comparison to the Company's filed case, to Avista's authorized recovery for capital additions, information services, executive labor and incentives, numerous categories of administrative and general expenses, and several power-supply related expenses. (emphasis added) (Exhibit JT-1T, at page 37)

These represent major concessions (and millions of dollars) in exchange for an earlier implementation date, and other components of the Settlement. Avista's participation in settlement negotiations also took into consideration the current difficult circumstances related to the economy, and concessions were made in light of those circumstances to minimize the rate impact on customers. The impact of these concessions is evident in the earnings guidance recently announced by Avista for 2011. The earnings guidance for Avista Utilities for 2011 is in the range of \$1.47 to \$1.62 per common share. For illustrative purposes only, if we were to assume that Avista's actual earnings for 2011 were in the middle of the earnings guidance, at \$1.55/share, it would result in a return on equity of 8.5 % (based on 56.6 million shares and \$1.03 billion of utility equity at 9/30/10). Even if the Company were to achieve the upper end of the range at \$1.62/share, the ROE would be 8.9%, which is still well below the 10.2% authorized by the Commission. Due in part to concessions already made during settlement negotiations, Avista will not fully recover its costs to provide service and does not expect to achieve the return authorized by the Commission in 2011.

The Company also took into consideration the need for rate relief necessary to achieve financial metrics that would support an upgrade to its credit rating, which is currently on the lowest rung of the investment grade scale. We are currently on Positive Outlook by both S&P and Moodys, and believe it important to preserve sufficient financial metrics that will hopefully enable a one-notch upgrade in the near future. In short, all components were carefully weighed in achieving the balancing of interests reflected in the Stipulation, and are integral to the Settlement.

With regard to the request in Bench Request No. 1 related to December 2010, the components of the Settlement that relate to 2010 are also critical elements to the Settlement package. As stated earlier, the Settlement provides for limited recovery (\$6.8 million) of Lancaster deferrals for 2010 and the elimination of ERM deferrals for 2010. As Mr. Norwood explained at the November 2nd hearing, the Lancaster deferral at September 30, 2010 stood at \$9.2 million, and there have been no deferrals under the ERM. Therefore, under the proposed Settlement, as of September 30, 2010 the Company would absorb \$2.4 million of the Lancaster deferral (\$9.2 million vs \$6.8 million), and thus far there is no benefit from the ERM (from the proposed elimination of ERM deferrals) for the Company. As Mr. Norwood explained at the hearing, the Company has guaranteed a benefit to customers in 2010 related to the Lancaster deferral, and has taken the risk on whether there will be any offsetting benefit to the Company from the elimination of ERM deferrals through December 2010.

5. At the November 2nd hearing in the exchange between Commissioner Jones and Mr. Norwood, Commission Jones indicated that if an update for power supply costs in the Settlement related to natural gas prices were to be considered, it may also be appropriate to take into consideration other changes in power supply-related costs since the Settlement was entered into. (TR. p.171, l.1-p.172, l.12.) There have been other changes in power supply-related costs since the Settlement was executed that result in an increase in power supply costs from that included in the Settlement. For example, on September 23rd, Avista entered into an agreement to purchase a slice of the output of Rocky Reach and Rock Island from Chelan PUD for the period July 2011 – December 2014. The purpose of the purchase is to maintain sufficient Mid-Columbia (Mid-C) capacity to provide important load following and regulation services for our customers. This purchase replaces a portion of Mid-C contracts that have expired. In addition, two units at Nine Mile Dam will be taken out of service beginning August 2011 to be rebuilt, which will result in reduced generation for 2011. New information shows that we will receive more energy from the WNP-3 Exchange contract for 2011, which will increase costs. And, Avista was recently notified that it will receive less low-cost energy from Grant PUD for 2011 than that included in the Settlement, which will result in increased costs. These changes, which are shown on Attachment 4, would increase power supply costs by \$1,088,000 on a system basis. This increase, combined with the decrease of \$2.55 million above, results in a net decrease of \$1.46 million on a system basis, or \$0.95 million for Washington's share.

As explained above, the net power supply expense on Appendix 2 of the Settlement Stipulation (Attachment 2 to this response) is \$181.0 million, or \$117.4 million for the Washington jurisdiction. A comparison of the \$0.95 million difference versus the \$117.4 million in the Settlement Stipulation shows that the difference in power supply costs is less than 1% of the net power supply costs included in the Settlement Stipulation.