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9 BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

10 DOCKET NO. UG-021584

11  
12 DIRECT TESTIMONY OF MICHAEL D'ARIENZO (MED-1T)

13 REPRESENTING AVISTA CORPORATION  
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## **I. INTRODUCTION**

**Q. Please state your name, business address and present position with Avista Corporation?**

A. My name is Michael D'Arienzo and my business address is 201 W. North River Drive, Suite 610, Spokane, Washington. I am presently Vice President, Natural Gas Marketing and Trading for Avista Energy.

**Q. Would you briefly describe your duties?**

A. My primary areas of responsibility include the management of the natural gas trading and marketing of Avista Energy.

**Q. Would you briefly describe your educational background?**

A. I graduated from Washington State University in 1981 with Bachelor degrees in Political Science and Public Administration and earned a Master Degree from Gonzaga University in 1990.

**Q. How long have you been employed by the Company?**

A. I have been employed by Avista Energy for five years. Prior to that I worked for BC Gas from 1993 to 1998 and Washington Water Power from 1983 to 1993 in the natural gas business.

**Q. Have you previously testified before the Commission?**

A. No.

**Q. What is the scope of your testimony in this proceeding?**

A. I will describe the benefits that Avista Energy (AE) offers Avista Utilities' customers under the Benchmark Mechanism, and briefly discuss how AE operates under the Mechanism.

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1           **Q.     Are you sponsoring any exhibits to be introduced in this proceeding?**

2           A.     No.

3           **Q.     Would you briefly describe Avista Energy's business operations?**

4           A.     Yes. AE, a subsidiary of Avista Corporation, is an electricity and natural  
5 gas marketing and trading business. We focus on asset-backed optimization of  
6 combustion turbines and hydroelectric assets owned by other entities, long-term electric  
7 supply contracts, natural gas storage, and electric and natural gas transmission and  
8 transportation arrangements. AE trades electricity and natural gas, along with derivative  
9 commodity instruments including futures, options, swaps, and other contractual  
10 arrangements. AE's marketing efforts are driven by its base of knowledge and  
11 experience in the operation of both electric and gas physical systems in the western  
12 U.S., as well as its relationship-focused approach with its customers.

13           **Q.     What share of Avista Energy's business is due to management of the**  
14 **Benchmark for gas operations only?**

15           A.     The Utility's load is approximately 8% of AE's total physical gas  
16 volumes traded. This is based on the physical volumes reported in the Avista  
17 Corporation 2002 10K.

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19                   **II. BENEFITS PROVIDED BY AVISTA ENERGY'S**  
20                   **MANAGEMENT UNDER THE BENCHMARK**

21           **Q.     Would you please explain the benefits that Avista Energy provides**  
22 **the Utility by managing their gas procurement operations?**

23           A.     AE's primary business focus with regard to natural gas is on the trading

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1 and marketing of natural gas in the Pacific Northwest. As part of its business model,  
2 AE has assembled a team of experts who have an excellent understanding of the  
3 physical flow of natural gas, as well as the financial markets and products that trade to  
4 meet the needs within the region. AE is a major participant in all periods and types of  
5 products traded, in both electricity and natural gas, and as a result, has greater  
6 opportunities to achieve lower costs for Avista Utilities' customers. AE is integrally  
7 involved in the daily activities of all areas of the natural gas market, thus AE is able to  
8 provide the Utility with a high degree of reliability, reduced risk to counter-party default  
9 and management of currency risk. If the Utility were managing this load amount, their  
10 level of activity in the market would be significantly less. This lower level of activity  
11 makes it difficult to transact as timely or as effectively, especially when there are  
12 significant time constraints or deadlines.

13 In addition, since AE is a subsidiary of Avista Corporation its interests are  
14 generally aligned with those of the Utility, since the Utility is the core of the  
15 Corporation. Therefore, it is in AE's best interest that Utility customers receive the best  
16 price and service possible.

17 **Q. Please describe the additional risks absorbed by AE through**  
18 **management of the Mechanism that would otherwise be borne by customers if**  
19 **managed by the Utility.**

20 A. Through consolidation of gas procurement operations under Avista  
21 Energy, the Utility has effectively shifted many of the costs and risks associated with the  
22 Utility's gas procurement operations to Avista Energy. Since the original Mechanism  
23 began in 1999, these costs and risks have increased significantly because of changes in

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1 the market. These include market liquidity, administrative costs, and legal risks. In  
2 addition, Avista Energy is responsible for the cost of physical gas, management of intra-  
3 month price volatility, credit and banking, currency risk, nomination errors, counter  
4 party risk, and some operation flow order risk and entitlement risk. Mr. Gruber has  
5 provided additional details and cost saving estimates related to Avista Energy bearing  
6 these risks.

7 **Q. Does AE believe they can manage these risks at a lower cost than the**  
8 **Utility can?**

9 A. Yes. A substantial part of AE's business is risk management. Given the  
10 size and volume of AE's trading operation, Avista Energy believes we can effectively  
11 manage these risks at a lower cost than the Utility, thus reducing risks and costs for  
12 Utility customers.

13  
14 **Value of Mechanism to Avista Energy:**

15 **Q. What benefits does Avista Energy receive from the Mechanism?**

16 A. Through the proposed Mechanism, AE would receive some  
17 compensation for its services through the \$900,000 per year management fee. In  
18 addition, AE has the opportunity to share in potential gains (and losses) through the  
19 symmetrical sharing incentives built into the Mechanism.

20 When taking into consideration the management fee to cover a portion of the  
21 known risks and costs listed earlier associated with providing services to the Utility,  
22 together with the symmetrical sharing opportunities, Avista Energy estimates it will  
23 receive an average benefit over time of approximately \$1 million annually. By

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1 comparison, Mr. Gruber has estimated Avista Utilities' customer benefits of  
2 approximately \$2.6 million annually.

### 3 4 **III. AVISTA ENERGY MANAGEMENT OF THE MECHANISM**

5 **Q. Mr. Gruber's testimony discusses how the Mechanism works,**  
6 **however, could you please discuss how AE manages the various components within**  
7 **the Mechanism?**

8 **A. Yes.** Even though each of the components has a separate set of  
9 operational constraints they are integrated into one overall supply portfolio to meet the  
10 load requirements of the Utility. Under the Commodity Component, the fixed price  
11 purchases and a Storage injection/withdrawal cycle accounts for about 50% of total  
12 customer load. The remaining 50% of Avista Utilities' average load is purchased in  
13 advance at first of the month (FOM) prices. Daily purchases and sales and storage gas  
14 are used to manage the swing around the average customer load each day.

15 AE manages the storage component of the Mechanism through injection of  
16 natural gas in the summer and withdrawal of natural gas in the winter. This allows for  
17 the capture of the winter/summer differentials in prices, which historically provides the  
18 most benefit to customers. The timing of the withdrawal of gas in winter months is  
19 designed to provide for a high level of reliability to the Utility's customers should  
20 extreme conditions occur. AE will use storage gas to meet customers daily load  
21 requirements, as long as it does not jeopardize reliability of supply. Pulling additional  
22 storage would be done in a period of high customer loads and high daily prices, where  
23 reliability is not compromised.

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1 AE manages the Transportation Component of the Mechanism through the  
2 optimization of unused pipeline capacity held by the Utility. This is accomplished  
3 through capacity releases and off-system sales to third parties. AE can provide  
4 substantially more benefits to customers than the Utility could provide. This is because:  
5 1) AE has a different risk profile than the utility, and 2) AE is a very active participant  
6 in the market. These two factors provide for a greater number of opportunities and  
7 more creative means to maximize the benefits achieved through the utilization of  
8 unused pipeline capacity to make off system sales. This utilization of the capacity to  
9 move physical gas at times has more value than simply releasing the capacity to a third  
10 party.

11 **Q. Would you please address the opportunity for Avista Utilities and**  
12 **Commission Staff to audit the transactions under the Proposed Mechanism?**

13 A. Yes. The books of AE are open for Avista Utilities and Commission  
14 Staff to audit. In the past, the Staff has spent time on the floor observing the morning  
15 trading activity to get a sense for how AE participates in the market. For the  
16 transactions such as the fixed price purchases of gas, we have deal tickets, taped lines,  
17 counter-party confirms and nucleus computer system reports which track all of AE's  
18 trades. Although the information regarding the transactions under the Mechanism will  
19 be confidential, it will be available to Avista Utilities and the Staff for their review.

20 **Q. Does this conclude your pre-filed direct testimony?**

21 A. Yes it does.  
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