BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

DIRECT TESTIMONY OF BRIAN J. HIRSCHKORN (BJH-1T)

REPRESENTING AVISTA CORPORATION

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

A. My name is Brian J. Hirschkorn and my business address is East 1411 Mission Avenue, Spokane, Washington. I am presently Manager Retail Pricing within the Rates and Regulation Department.

Q. Would you briefly describe your duties?

A. My primary areas of responsibility include electric and gas rate design, customer usage and revenue analysis, and tariff administration.

Q. Would you briefly describe your educational background?

A. I graduated from Washington State University in 1978 with Bachelor degrees in Business Administration and Accounting.

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

A. I have been employed by the Company for 25 years, and have been involved in nearly all rate design and special customer contract matters at the Company during that time.

Q. Have you previously testified before the Commission?

A. Yes. I have testified before this Commission in many prior rate proceedings as a revenue, rate design, and special contract witness.

Q. Would you briefly describe the issues that you address in your direct testimony?

A. Yes. My testimony will address the accounting for the Natural Gas Benchmark Mechanism (Mechanism), through the Purchase Gas Cost Adjustment. My testimony also includes the proposed Tariff 163 "Natural Gas Benchmark

Mechanism" filed with this case.

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

A. Yes. I am sponsoring Exhibit No. __(BJH-2) and Exhibit No. __(BJH-3). Which will be explained later in my testimony.

Q. Could you please describe how the Mechanism is accounted for?

A. Yes. The current Mechanism works in conjunction with the existing Purchased Gas Cost Adjustment (PGA), Tariff Schedules 150 and 156. Under Tariff Schedule 150, the Company maintains a PGA balancing account 191 whereby monthly entries defer the over or under collection of purchased gas costs. These entries reflect the difference between actual purchased gas costs collected from customers, as approved in the Company's last PGA filing, and the purchased gas costs determined under Schedule 163 – Natural Gas Benchmark Mechanism. The differences are then collected from or refunded to customers in the next PGA filing under Schedule 155 – Gas Rate Adjustment.

Additional debits and credits for pipeline refunds or charges and other miscellaneous revenues or expenses directly related to the Company's cost of purchasing gas to meet customers' needs are also recorded in the balancing account. In addition, the Company computes interest on the average deferred balance of the PGA balancing account on a monthly basis using an interest rate based on its variable short-term borrowing cost.

Total deferred gas costs are determined for individual customers served under Schedules 112, 122, 132, 146 and 148, as well as for customers that switch to or from any of these service schedules to another schedule. The deferred gas cost balance for these customers will be based on monthly entries into the balancing account as described above. The deferred gas cost balance for each customer will be eliminated by either 1) a lump-sum refund or surcharge, as applicable, or 2) an amortization rate per therm to reduce the balance prospectively.

Q. How does the Company report the activity relating to the Mechanism?

A. The Company files quarterly reports to the Commission summarizing the activity and market indicators related to the Mechanism and the Agency Agreement with Avista Energy. This summary information and documentation includes retail customer usage by jurisdiction, Index prices for appropriate months, capacity releases, off-system sales, calculation of associated margins, all hedging and fixed pricing locked in for the Utility, invoices between Avista Energy and Avista Utilities as well as Avista Utilities' accounting transactions.

In addition to the quarterly reports Avista Utilities and Avista Energy continue to cooperate with Commission Staff on reviews of Avista Energy operations, on a confidential basis, as they relate to the Agency Agreement, included but not limited to, responding to data requests and opening Avista Energy books for Staff review.

Q. Why is the Company proposing the changes made within Tariff Schedule 163?

A. As described in Mr. Gruber's testimony, changes are being proposed to the existing Tariff Schedule 163, see Exhibit No. __(BJH-2), in order to address issues within the current Mechanism raised by Staff. These changes include added flexibility within the use of Storage, resolution of auditability issues, and built in symmetrical incentives related to gains and losses for basin optimization, transportation, storage and commodity costs and benefits.

Q. Does the proposed Tariff Schedule 163 incorporate the proposed changes to the Mechanism as described by Mr. Gruber?

A. Yes, the proposed revisions are incorporated in the proposed Tariff Schedule 163.

Q. What is the requested effective date and timeframe of the proposed Tariff Schedule 163?

A. The Company is requesting that the Commission approve the proposed Mechanism and the proposed Tariff Schedule 163 to become effective January 30, 2004 and remain in effect for a three year and two month period ending March 31, 2007.

Q. Is the Company proposing a change in rates or annual revenue in this filing?

A. No. Changes to rates or annual revenue related to gas costs are requested during the annual Purchase Gas Cost Adjustment filing which generally occurs in the fall.

Q. Has the Company included a copy of the tariff that was suspended by the Commission?

A. Yes. Please see Exhibit__(BJH-3). While approval by the Commission of either the tariffs suspended on January 29, 2003, or the tariff revisions submitted with this April 21, 2003 filing is acceptable to the Company, Avista has submitted the

April 21, 2003 tariff revisions as the preferred alternative, in that the revisions directly address the recent concerns raised by Staff.

Q. Does that conclude your direct testimony in this proceeding?

A. Yes, it does.

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

EXHIBIT NO. __ (BJH-2)

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163

Natural Gas Benchmark Mechanism

APPLICABILITY:

The Natural Gas Benchmark Mechanism described herein shall establish the natural gas costs for Purchase Gas Adjustment (PGA) deferral purposes on a monthly basis. The difference between the monthly Benchmark Mechanism costs and the costs included in Customers' rates for the respective month will be deferred. This difference in gas costs shall be refunded or surcharged to Customers under Schedule 155 - Gas Rate Adjustment.

PURPOSE:

The Benchmark Mechanism provides an incentive to the Company to minimize natural gas costs for Customers, and will provide additional natural gas cost savings for Customers. Under the Benchmark Mechanism, Avista Energy will act as agent for Avista Utilities to manage the Company's natural gas storage and existing transportation and supply contracts. Benefits to Avista Energy from the Benchmark Mechanism are performance based and are dependent on the success of Avista Energy in managing natural gas supplies, transportation and storage.

TERM:

The Benchmark Mechanism described herein shall become effective January 30, 2004 and shall remain in effect until March 31, 2007. If the mechanism is terminated, any outstanding hedging obligations will be assigned to the Utility.

DEFINITIONS:

1. First of The Month (FOM) Weighted Average Index Price: The weighted average of the published index prices for the following three supply basins: AECO-C (Alberta), Sumas (British Columbia), and Rockies (Domestic). The price at each basin shall be the actual "first of the month" prices as reported in *Canadian Gas Price Reporter* and *Inside FERC Gas Market Report* for the applicable supply basins. The published index prices shall be weighted with a minimum of 50% AECO-C, 18% Sumas, and 18% Rockies. Each year the remaining 14% shall be assigned to one or more of the three supply basins for the following November 1st to October 31st twelve-month period, as described below. In the application of the floating 14% to supply basins, the resulting total percentage assigned each basin shall be subject to any physical constraints to transport that quantity of natural gas from the basin to the

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SCHEDULE 163 - continued

Company's system. However, the percentage assigned to Sumas or Rockies can not exceed 25%. The Company shall notify the Commission in writing, with justification, of the assignment of the 14% to supply basins on or before January 1st of each year. The Commission shall review the proposed assignment and notify the Company of its decision on or before February 1st of each year. The initial assignment for the 14% floating percentage, through October 31, 2002, shall be to AECO-C, resulting in basin weighting percentages of 64% AECO-C, 18% Sumas, and 18% Rockies.

2. Gas Daily (GD) Weighted Average Index Price: The weighted average of the published daily index prices for the three supply basins, AECO-C (Alberta), Sumas (British Columbia), and Rockies (Kern River/Opal plant) will be calculated on the same basin percentages as the FOM Weighted Average Index Price. The price at each basin shall be the midpoint "Gas Daily" prices as reported in the McGraw Hill's *Gas Daily* for the applicable supply basins.

3. Jackson Prairie (JP) Storage Benchmark Schedule (JP Cycle): Customers receive cost savings from Company injections of natural gas into JP Storage during the generally lower-cost spring and summer months and withdrawals of gas during the higher-cost winter months. A JP Storage injection and withdrawal schedule, including Injections between May and September and Withdrawals between December and March shall be established as a guideline to continue to provide Customers with the benefits associated with JP Storage.

The cost of natural gas for injections, per the Benchmark Schedule, shall be the Weighted Average Index Price for the respective month. Avista Utilities shall pay Avista Energy for the cost of gas added to inventory on a monthly basis, per the Benchmark Schedule, and will receive a credit from Avista Energy for withdrawals under the Benchmark Schedule.

If the management of JP Storage is transferred back to the utility in the future, the inventory volume balance and the cost of inventory shall be transferred to Avista Utilities per the balances under the JP Storage Benchmark Schedule.

4. Actual Avista Energy daily price (AE daily price): The Average sales prices or average purchase price for each supply basin, based on Avista Energy's actual transactions for the day.

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163 – continued

5. Pipeline Capacity Release/Off-System Sales includes net revenues associated with pipeline capacity releases and sales of natural gas for resale using the Company's contracted pipeline transportation.

6. Administrative Cost Savings: Through consolidation of natural gas procurement operations, the Company has achieved administrative cost savings. The Benchmark Mechanism shall flow these benefits through to sales Customers. The level of Administrative Cost Savings shall be fixed at $22,400 on an annual basis, or until the cost savings are reflected in rates through a rate proceeding.

7. Operational Flow Orders (OFO): Operational Flow Orders are issued by the pipeline and direct shippers to flow gas on particular segments of the pipeline to maintain certain physical flow characteristics in order to ensure operational stability. Failure to follow OFO's results in substantial penalties.

CALCULATION OF MONTHLY GAS COSTS FOR DEFERRAL PURPOSES:

The Company shall maintain a PGA Balancing Account whereby monthly entries into this Balancing Account shall be made to reflect differences between the actual Purchase Gas Costs collected from customers and the Purchase Gas Costs determined under this Schedule 163 - Natural Gas Benchmark Mechanism as follows:

1. Commodity Costs: Gas purchases to serve customer usage will be made utilizing three pricing mechanisms (Tiers): (1) fixed price purchases including a predetermined level of storage withdrawal from JP, (2) first of month (FOM) Weighted Average Index Price of gas purchases to the Company's estimated average daily load, and (3) Daily purchases or sales to balance supply with load at AE daily price, including any peaking service supplied from early injection or withdrawal of Jackson Prairie (JP) and from Plymouth Storage facilities. The System (WA/ID) daily volumes of gas that will be purchased in Tier1 and Tier 2 will be predetermined for each month, based on a statistical analysis of historical customer usage. The total cost of all gas delivered in each Tier during a month will be the Commodity Cost for that month.

Tier 1 - Customer usage to be purchased and priced under Tier 1 – Fixed Price Purchases will include a predetermined daily level of gas each month purchased for future delivery using futures contracts or hedging instruments, and withdrawal of storage gas under the JP Storage Benchmark schedule.

Tier 2 - Customer usage to be purchased and priced at Tier 2 - FOM Weighted Average Index Price will include a predetermined average daily usage level of gas for each month.

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163 – continued

Tier 3 - Customer usage to be priced at Tier 3 – Daily usage that is above or below the average daily volumes purchased as Tier 2, as determined for each of the three supply basins. This daily usage will be supplied through the use of the Company's Jackson Prairie and Plymouth storage facilities, rather than daily purchases, when it is economically reasonable, provided such usage will not hamper the availability of storage to meet estimated late winter loads. If storage is used, supply from JP will be utilized first up to the maximum capabilities of the facility. Supply from Plymouth LNG would then be utilized to meet any remaining customer usage. Supplies from these facilities will be priced at the respective inventory Weighted Average Cost for Gas of each facility. The balance of the month and the following month's JP withdrawal schedule will be adjusted to reflect any early withdrawals. At the discretion of Avista Energy, refilling of Plymouth will take place as soon as appropriate and will be priced at the current FOM index.

The cost of Tier 3 volumes will be determined by multiplying Tier 3 volumes provided by basin times Avista Energy's actual average purchase or sales price (AE daily price) at that basin for that day. Volumes provided under Tier 3 will be supplied from the lowest-cost basin based on remaining available transportation at each basin. (Volumes supplied under Tiers 1 and 2 will maximize volumes available at the lowest cost basins each day.) Sales of Tier 3 gas will be made at the highest-priced basin(s) where gas has been pre-purchased. If Avista Energy does not have actual transactions at a supply basin for the given day to calculate the AE daily price, Gas Daily index price for that supply basin will be used. The weighted average cost of Tier 3 volumes for each day will be compared to the FOM index. The difference will then be multiplied by Tier 3 volumes for that day and the result shared 80% to customers and 20% to Avista Energy.

Basin Optimization: All transactions entered into by Avista Energy that maximize the amount of gas to be delivered from the lowest-cost basin (Basin Optimization), will shared 80% to customers and 20% to Avista Energy.

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SCHEDULE 163 - continued

2. JP Storage: During months when there are withdrawals of natural gas from JP Storage, per the Benchmark schedule, an adjustment will be made to total commodity gas costs based on the scheduled volume of gas withdrawn from JP Storage, times the difference between 1) the average inventory cost of gas in JP Storage, and 2) the FOM Index Price. The adjustment to the commodity cost shall be 80% of this amount (20% to Avista Energy).

Storage volumes may be withdrawn earlier than scheduled if the applicable forward price of gas is less than the daily price and there are no reliability constraints. The financial benefit resulting from early withdrawls, will be determined by subtracting the applicable forward price from the daily price multiplied by the volumes withdrawn. Early storage withdrawl benefits will be shared 80% to customers and 20% to Avista Energy.

3. Pipeline Transportation and Storage Costs: Total Company pipeline transportation and storage costs shall be included for deferral purposes. This will include all fixed and variable charges, less any variable charges incurred related to off-system sales. Avista Energy shall credit or reimburse Avista Utilities for any variable transportation or storage charges related to off-system sales.

4. Pipeline Capacity Release and Off-System Sales Benefits: Benefits to Customers related to the release of pipeline capacity and off-system sales using the Company's transportation shall be calculated as follows:

a. Actual capacity release and off-system sales benefits shall be accumulated for the April through March period each year. Avista Energy shall guarantee benefits of $3,000,000 to Washington Customers on an annualized basis. During the period, the actual margins in excess of $3,000,000 shall be shared 80% to Customers and 20% to Avista Energy.
b. Actual Capacity Release margins shall be equal to the actual margin, allocable to the Washington jurisdiction, associated with the release of the Avista Utilities' (WA/ID Division) capacity on a transaction by transaction basis.
c. Actual Off-System Sales margins shall be calculated as 80% to customers and 20% to Avista energy of the actual delivered volumes moved on the Avista Utilities' (WA/ID Division) transportation to off-system parties, multiplied by the difference between the published delivery point index price and the published receipt point index price for the relevant time period, e.g., daily or monthly, net of variable transportation and fuel charges. Washington Customers shall receive an allocated share based on a system contract demand allocator.

AVISTA CORPORATION
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SCHEDULE 163 - continued

5. Management Fee: Avista Energy shall bill the Company a monthly Management Fee of $75,000 each month ($900,000 annually).

6. Administrative Cost Savings: Natural gas costs shall be reduced by the fixed Administrative Cost Savings benefit of approximately $1,867 per month ($22,400 annually) until these cost savings are reflected in rates through a rate proceeding.

7. The difference between the monthly Benchmark Mechanism costs, as described above, and the costs included in Customers' rates for the respective month shall be deferred to Account 191.31 for later refund or surcharge to Customers under Schedule 155 - Gas Rate Adjustment.

8. Contract Specific Operation Flow Order (OFO): As a result of various segmented capacity releases in the past, the Company is exposed to contract specific OFO's on Northwest Pipeline's system from the Jackson Prairie receipt point west to east through the Columbia River Gorge.

If contract specific OFO's are imposed on the Company from JP through the Columbia River Gorge that cause Avista Energy to schedule deliveries from points west of the Gorge on any day that exceed volumes calculated by the following formula then the Company will pay Avista Energy's actual daily cost of gas for such volumes: ((DSL – SSW) * BWP) + SSW. (Where DSL = daily system load, SSW = daily Synthetic Storage Withdrawal volume from Jackson Prairie Storage, BWP = basin weighting percentage from Sumas.)

If contract specific OFO's are called which would result in daily pricing Avista Energy will communicate with the Company on the impact and the Company may determine if it would be appropriate to satisfy the OFO with storage withdrawal and adjustments to forward synthetic storage schedules.

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SCHEDULE 163

Natural Gas Benchmark Mechanism

APPLICABILITY:

The Natural Gas Benchmark Mechanism described herein shall establish the natural gas costs for Purchase Gas Adjustment (PGA) deferral purposes on a monthly basis. The difference between the monthly Benchmark Mechanism costs and the costs included in Customers' rates for the respective month will be deferred. This difference in gas costs shall be refunded or surcharged to Customers under Schedule 155 - Gas Rate Adjustment.

PURPOSE:

The Benchmark Mechanism provides an incentive to the Company to minimize natural gas costs for Customers, and will provide additional natural gas cost savings for Customers. Under the Benchmark Mechanism, Avista Energy will act as agent for Avista Utilities to manage the Company's natural gas storage and existing transportation and supply contracts. Benefits to Avista Energy from the Benchmark Mechanism are performance based and are dependent on the success of Avista Energy in managing natural gas supplies, transportation and storage. (T)

TERM:

The Benchmark Mechanism described herein shall become effective January 30, 2004 and shall remain in effect until March 31, 2007. If the mechanism is terminated, any outstanding hedging obligations will be assigned to the Utility. (C) (C)

DEFINITIONS:

1. First of The Month (FOM) Weighted Average Index Price: The weighted average of the published index prices for the following three supply basins: AECO-C (Alberta), Sumas (British Columbia), and Rockies (Domestic). The price at each basin shall be the actual "first of the month" prices as reported in *Canadian Gas Price Reporter* and *Inside FERC Gas Market Report* for the applicable supply basins. The published index prices shall be weighted with a minimum of 50% AECO-C, 18% Sumas, and 18% Rockies. Each year the remaining 14% shall be assigned to one or more of the three supply basins for the following November 1st to October 31st twelve-month period, as described below. In the application of the floating 14% to supply basins, the resulting total percentage assigned each basin shall be subject to any physical constraints to transport that quantity of natural gas from the basin to the

Issued April 18, 2003 Effective January 30, 2004

Issued by Avista Corporation
By Kelly O. Norwood, Vice President

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SCHEDULE 163 - continued

Company's system. However, the percentage assigned to Sumas or Rockies can not exceed 25%. The Company shall notify the Commission in writing, with justification, of the assignment of the 14% to supply basins on or before January 1st of each year. The Commission shall review the proposed assignment and notify the Company of its decision on or before February 1st of each year. The initial assignment for the 14% floating percentage, through October 31, 2002, shall be to AECO-C, resulting in basin weighting percentages of 64% AECO-C, 18% Sumas, and 18% Rockies.

2. Gas Daily (GD) Weighted Average Index Price: The weighted average of the published daily index prices for the three supply basins, AECO-C (Alberta), Sumas (British Columbia), and Rockies (Kern River/Opal plant) will be calculated on the same basin percentages as the FOM Weighted Average Index Price. The price at each basin shall be the midpoint "Gas Daily" prices as reported in the McGraw Hill's *Gas Daily* for the applicable supply basins. (D)

3. Jackson Prairie (JP) Storage Benchmark Schedule (JP Cycle): Customers receive cost savings from Company injections of natural gas into JP Storage during the generally lower-cost spring and summer months and withdrawals of gas during the higher-cost winter months. A JP Storage injection and withdrawal schedule, including Injections between May and September and Withdrawals between December and March shall be established as a guideline to continue to provide Customers with the benefits associated with JP Storage. (D)

The cost of natural gas for injections, per the Benchmark Schedule, shall be the Weighted Average Index Price for the respective month. Avista Utilities shall pay Avista Energy for the cost of gas added to inventory on a monthly basis, per the Benchmark Schedule, and will receive a credit from Avista Energy for withdrawals under the Benchmark Schedule. (C)

If the management of JP Storage is transferred back to the utility in the future, the inventory volume balance and the cost of inventory shall be transferred to Avista Utilities per the balances under the JP Storage Benchmark Schedule.

4. Actual Avista Energy daily price (AE daily price): The Average sales prices or (C)
average purchase price for each supply basin, based on Avista Energy's actual (C)
transactions for the day. (C)

AVISTA CORPORATION
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SCHEDULE 163 – continued

5. Pipeline Capacity Release/Off-System Sales includes net revenues associated with pipeline capacity releases and sales of natural gas for resale using the Company's contracted pipeline transportation.

6. Administrative Cost Savings: Through consolidation of natural gas procurement operations, the Company has achieved administrative cost savings. The Benchmark Mechanism shall flow these benefits through to sales Customers. The level of Administrative Cost Savings shall be fixed at $22,400 on an annual basis, or until the cost savings are reflected in rates through a rate proceeding.

7. Operational Flow Orders (OFO): Operational Flow Orders are issued by the pipeline and direct shippers to flow gas on particular segments of the pipeline to maintain certain physical flow characteristics in order to ensure operational stability. Failure to follow OFO's results in substantial penalties.

CALCULATION OF MONTHLY GAS COSTS FOR DEFERRAL PURPOSES:

The Company shall maintain a PGA Balancing Account whereby monthly entries into this Balancing Account shall be made to reflect differences between the actual Purchase Gas Costs collected from customers and the Purchase Gas Costs determined under this Schedule 163 - Natural Gas Benchmark Mechanism as follows:

1. Commodity Costs: Gas purchases to serve customer usage will be made utilizing three pricing mechanisms (Tiers): (1) fixed price purchases including a predetermined level of storage withdrawal from JP, (2) first of month (FOM) Weighted Average Index Price of gas purchases to the Company's estimated average daily load, and (3) Daily purchases or sales to balance supply with load at AE daily price, including any peaking service supplied from early injection or withdrawal of Jackson Prairie (JP) and from Plymouth Storage facilities. The System (WA/ID) daily volumes of gas that will be purchased in Tier1 and Tier 2 will be predetermined for each month, based on a statistical analysis of historical customer usage. The total cost of all gas delivered in each Tier during a month will be the Commodity Cost for that month. (C) (C)

Tier 1 - Customer usage to be purchased and priced under Tier 1 – Fixed Price Purchases will include a predetermined daily level of gas each month purchased for future delivery using futures contracts or hedging instruments, and withdrawal of storage gas under the JP Storage Benchmark schedule.

Tier 2 - Customer usage to be purchased and priced at Tier 2 - FOM Weighted (C)
Average Index Price will include a predetermined average daily usage level of gas for (C)
each month. (D)

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SCHEDULE 163 – continued

Tier 3 - Customer usage to be priced at Tier 3 – Daily usage that is above or below the average daily volumes purchased as Tier 2, as determined for each of the three supply basins. This daily usage will be supplied through the use of the Company's Jackson Prairie and Plymouth storage facilities, rather than daily purchases, when it is economically reasonable, provided such usage will not hamper the availability of storage to meet estimated late winter loads. If storage is used, supply from JP will be utilized first up to the maximum capabilities of the facility. Supply from Plymouth LNG would then be utilized to meet any remaining customer usage. Supplies from these facilities will be priced at the respective inventory Weighted Average Cost for Gas of each facility. The balance of the month and the following month's JP withdrawal schedule will be adjusted to reflect any early withdrawals. At the discretion of Avista Energy, refilling of Plymouth will take place as soon as appropriate and will be priced at the current FOM index. (C) (C) (C) (C)

The cost of Tier 3 volumes will be determined by multiplying Tier 3 volumes provided by basin times Avista Energy's actual average purchase or sales price (AE daily price) at that basin for that day. Volumes provided under Tier 3 will be supplied from the lowest-cost basin based on remaining available transportation at each basin. (Volumes supplied under Tiers 1 and 2 will maximize volumes available at the lowest cost basins each day.) Sales of Tier 3 gas will be made at the highest-priced basin(s) where gas has been pre-purchased. If Avista Energy does not have actual transactions at a supply basin for the given day to calculate the AE daily price, Gas Daily index price for that supply basin will be used. The weighted average cost of Tier 3 volumes for each day will be compared to the FOM index. The difference will then be multiplied by Tier 3 volumes for that day and the result shared 80% to customers and 20% to Avista Energy. (N) (N)

Basin Optimization: All transactions entered into by Avista Energy that maximize the amount of gas to be delivered from the lowest-cost basin (Basin Optimization), will shared 80% to customers and 20% to Avista Energy. (D)

(D)

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163 - continued

2. JP Storage: During months when there are withdrawals of natural gas from JP Storage, per the Benchmark schedule, an adjustment will be made to total commodity gas costs based on the scheduled volume of gas withdrawn from JP Storage, times the difference between 1) the average inventory cost of gas in JP Storage, and 2) the FOM Index Price. The adjustment to the commodity cost shall be 80% of this amount (20% to Avista Energy). (C) (N)

Storage volumes may be withdrawn earlier than scheduled if the applicable forward price of gas is less than the daily price and there are no reliability constraints. The financial benefit resulting from early withdrawls, will be determined by subtracting the applicable forward price from the daily price multiplied by the volumes withdrawn. Early storage withdrawl benefits will be shared 80% to customers and 20% to Avista Energy. (N) (N)

3. Pipeline Transportation and Storage Costs: Total Company pipeline transportation and storage costs shall be included for deferral purposes. This will include all fixed and variable charges, less any variable charges incurred related to off-system sales. Avista Energy shall credit or reimburse Avista Utilities for any variable transportation or storage charges related to off-system sales.

4. Pipeline Capacity Release and Off-System Sales Benefits: Benefits to Customers related to the release of pipeline capacity and off-system sales using the Company's transportation shall be calculated as follows:

a. Actual capacity release and off-system sales benefits shall be accumulated for the April through March period each year. Avista Energy shall guarantee benefits of $3,000,000 to Washington Customers on an annualized basis. During the period, the actual margins in excess of $3,000,000 shall be shared 80% to Customers and 20% to Avista Energy. (C) (C) (C)

b. Actual Capacity Release margins shall be equal to the actual margin, allocable to the Washington jurisdiction, associated with the release of the Avista Utilities' (WA/ID Division) capacity on a transaction by transaction basis. (C)

c. Actual Off-System Sales margins shall be calculated as 80% to customers and 20% to Avista energy of the actual delivered volumes moved on the Avista Utilities' (WA/ID Division) transportation to off-system parties, multiplied by the difference between the published delivery point index price and the published receipt point index price for the relevant time period, e.g., daily or monthly, net of variable transportation and fuel charges. Washington Customers shall receive an allocated share based on a system contract demand allocator. (C)

(K)

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163 - continued

5. Management Fee: Avista Energy shall bill the Company a monthly Management Fee of $75,000 each month ($900,000 annually). (N) (N)

6. Administrative Cost Savings: Natural gas costs shall be reduced by the fixed Administrative Cost Savings benefit of approximately $1,867 per month ($22,400 annually) until these cost savings are reflected in rates through a rate proceeding. (M) (C) (M)

7. The difference between the monthly Benchmark Mechanism costs, as described above, and the costs included in Customers' rates for the respective month shall be deferred to Account 191.31 for later refund or surcharge to Customers under Schedule 155 - Gas Rate Adjustment.

8. Contract Specific Operation Flow Order (OFO): As a result of various segmented capacity releases in the past, the Company is exposed to contract specific OFO's on Northwest Pipeline's system from the Jackson Prairie receipt point west to east through the Columbia River Gorge.

If contract specific OFO's are imposed on the Company from JP through the Columbia River Gorge that cause Avista Energy to schedule deliveries from points west of the Gorge on any day that exceed volumes calculated by the following formula then the Company will pay Avista Energy's actual daily cost of gas for such volumes:
((DSL – SSW) * BWP) + SSW. (Where DSL = daily system load, SSW = daily Synthetic Storage Withdrawal volume from Jackson Prairie Storage, BWP = basin weighting percentage from Sumas.)

If contract specific OFO's are called which would result in daily pricing Avista Energy will communicate with the Company on the impact and the Company may determine if it would be appropriate to satisfy the OFO with storage withdrawal and adjustments to forward synthetic storage schedules.

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BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UG-021584

EXHIBIT NO. __ (BJH-3)

AVISTA CORPORATION
dba Avista Utilities

SCHEDULE 163

Natural Gas Benchmark Mechanism

APPLICABILITY:

The Natural Gas Benchmark Mechanism described herein shall establish the natural gas costs for Purchase Gas Adjustment (PGA) deferral purposes on a monthly basis. The difference between the monthly Benchmark Mechanism costs and the costs included in Customers' rates for the respective month will be deferred. This difference in gas costs shall be refunded or surcharged to Customers under Schedule 155 - Gas Rate Adjustment.

PURPOSE:

The Benchmark Mechanism will provide an incentive to the Company to minimize natural gas costs, and will provide additional natural gas cost savings for Customers. Under the Benchmark Mechanism, Avista Energy will act as agent for Avista Utilities to manage the Company's natural gas storage and existing transportation and supply contracts. Benefits to Avista Energy from the Benchmark Mechanism are performance based and are dependent on the success of Avista Energy in managing natural gas supplies, transportation and storage.

TERM:

The Benchmark Mechanism described herein shall become effective April 1, 2003, and shall remain in effect until March 31, 2005. The Company may seek continuation of the authorization for the Benchmark Mechanism with a tariff or petition filing within six months notice or September 30, 2004, and a Commission decision necessary by February 1, 2005. If the mechanism is terminated, any outstanding hedging obligations will be assigned to the Utility

DEFINITIONS:

1. First of The Month (FOM) Weighted Average Index Price: The weighted average of the published index prices for the following three supply basins: AECO-C (Alberta), Sumas (British Columbia), and Rockies (Domestic). The price at each basin shall be the actual "first of the month" prices as reported in *Canadian Gas Price Reporter* and *Inside FERC Gas Market Report* for the applicable supply basins. The published index prices shall be weighted with a minimum of 50% AECO-C, 18% Sumas, and 18% Rockies. Each year the remaining 14% shall be assigned to one or more of the three supply basins for the following November 1st to October 31st twelve-month period, as described below. In the application of the floating 14% to supply basins, the resulting total percentage assigned each basin shall be subject to any physical constraints to transport that quantity of natural gas from the basin to the

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Company's system. However, the percentage assigned to Sumas or Rockies can not exceed 25%. The Company shall notify the Commission in writing, with justification, of the assignment of the 14% to supply basins on or before January 1st of each year. The Commission shall review the proposed assignment and notify the Company of its decision on or before February 1st of each year. The initial assignment for the 14% floating percentage, through October 31, 2002, shall be to AECO-C, resulting in basin weighting percentages of 64% AECO-C, 18% Sumas, and 18% Rockies.

2. Gas Daily (GD) Weighted Average Index Price: The weighted average of the published daily index prices for the three supply basins, AECO-C (Alberta), Sumas (British Columbia), and Rockies (Kern River/Opal plant) will be calculated on the same basin percentages as the FOM Weighted Average Index Price. The price at each basin shall be the midpoint "Gas Daily" prices as reported in the McGraw Hill's *Gas Daily* for the applicable supply basins.

3. Index Adder: A fixed amount, expressed in cents per dekatherm, that shall be added to the actual cost or index price, as applicable, for all purchases. The Index Adder shall be fixed at $0.05 per dekatherm for all volumes of gas purchased for the term of the Benchmark Mechanism.

4 Jackson Prairie (JP) Storage Benchmark Schedule (JP Cycle): Customers receive cost savings from Company injections of natural gas into JP Storage during the, generally, lower-cost spring and summer months and withdrawals of gas during the higher-cost winter months. A system (WA and ID) JP Storage injection and withdrawal schedule shall be established annually to continue to provide Customers with the benefits associated with JP Storage.

The cost of natural gas for injections, per the Benchmark Schedule, shall be the Weighted Average Index Price for the respective month, plus the Index Adder. Avista Utilities shall pay Avista Energy for the cost of gas added to inventory on a monthly basis, per the Benchmark Schedule, and will receive a credit from Avista Energy for withdrawals under the Benchmark Schedule.
If the management of JP Storage is transferred back to the utility in the future, the inventory volume balance and the cost of inventory shall be transferred to Avista Utilities per the balances under the JP Storage Benchmark Schedule.

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5. Pipeline Capacity Release/Off-System Sales includes net revenues associated with pipeline capacity releases and sales of natural gas for resale using the Company's transportation system.

6. Administrative Cost Savings: Through consolidation of natural gas procurement operations, the Company has achieved administrative cost savings. The Benchmark Mechanism shall flow these benefits through to sales Customers. The level of Administrative Cost Savings shall be fixed at $80,600 on an annual basis, or until the cost savings are reflected in rates through a rate proceeding.

7. Operational Flow Orders (OFO): Operational Flow Orders are issued by the pipeline and direct shippers to flow gas on particular segments of the pipeline to maintain certain physical flow characteristics in order to ensure operational stability. Failure to follow OFO's results in substantial penalties.

CALCULATION OF MONTHLY GAS COSTS FOR DEFERRAL PURPOSES:

The Company shall maintain a PGA Balancing Account whereby monthly entries into this Balancing Account shall be made to reflect differences between the actual Purchase Gas Costs collected from customers and the Purchase Gas Costs determined under this Schedule 163 - Natural Gas Benchmark Mechanism as follows:

1. Commodity Costs: Gas purchases to serve customer usage will be made utilizing four pricing mechanisms (Tiers): (1) fixed price purchases including a predetermined level of storage withdrawal from JP, (2) first of month (FOM) Weighted Average Index Price, (3) Gas Daily (GD) weighted average index price and (4) peaking service supplied from early withdrawal of Jackson Prairie (JP) and from Plymouth Storage facilities. The System (WA/ID) daily volumes of gas that will be priced in each Tier will be predetermined for each month, based on a statistical analysis of historical customer usage. <u>All purchases or priced volumes included in each Tier will include the $0.05 index adder.</u> The total cost of all gas delivered in each Tier during a month will be the Commodity Cost for that month.

Tier 1 - Customer usage to be purchased and priced under Tier 1 – Fixed Price Purchases will include a predetermined daily level of gas each month purchased for future delivery using futures contracts or hedging instruments, and withdrawal of storage gas under the JP Storage Benchmark schedule.

Tier 2 - Customer usage to be priced at Tier 2 - FOM Weighted Average Index Price will include a minimum and maximum daily usage level for each month. All customer usage each day that exceeds the minimum level and is less than the maximum level will be priced at the FOM Weighted Average Index Price. For any days where customer usage is less than the minimum Tier 2 level and higher than the Tier 1 level, gas costs associated with the minimum daily volume will be recorded at the FOM

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Weighted Average Index Price and the difference between the minimum daily volume and actual usage will be assumed to be sold at the Weighted Average Gas Daily Index and the proceeds used to offset gas costs.

Tier 3 - Customer usage to be priced at Tier 3 – Gas Daily Weighted Average Index Price is the amount of daily usage that exceeds the maximum usage level set forth under Tier 2 and is less than the maximum usage level for Tier 3. IF actual usage exceeds Tier 3 maximum levels, the excess will be priced under Tier 3 guidelines unless the usage occurs during the period November 20th through February 10th, at that time Tier 4 pricing would apply.

Tier 4 - Customer usage that exceeds the maximum daily usage level under Tier 3 for the period from November 20th through February 10th will be supplied through the use of the Company's Jackson Prairie and Plymouth storage facilities, rather than Gas Daily, when it is economically reasonable provided such usage will not seriously hamper the availability of storage to meet estimated late winter loads. If supply is used, supply from JP will be utilized first up to the maximum capabilities of the facility. Supply from Plymouth LNG would then be utilized to meet any remaining customer usage. Supplies from these facilities will be priced at the respective inventory Weighted Average Cost for Gas of each facility. The balance of the month and the following month's JP withdrawal schedule will be adjusted to reflect any early withdrawals. At the discretion of Avista Energy, refilling of Plymouth will take place as soon as appropriate and will be priced at the current FOM index plus the Adder.

(Continued)

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2. JP Storage: During months when there are withdrawals of natural gas from JP Storage, per the Benchmark schedule, an adjustment will be made to total commodity gas costs based on the scheduled volume of gas withdrawn from JP Storage, times the difference between 1) the average inventory cost of gas in JP Storage, and 2) the Weighted Average Index Price plus the Index Adder.

3. Pipeline Transportation and Storage Costs: Total Company pipeline transportation and storage costs shall be included for deferral purposes. This will include all fixed and variable charges, less any variable charges incurred related to off-system sales. Avista Energy shall credit or reimburse Avista Utilities for any variable transportation or storage charges related to off-system sales.

4. Pipeline Capacity Release and Off-System Sales Benefits: Benefits to Customers related to the release of pipeline capacity and off-system sales using the Company's transportation shall be calculated as follows:

a. Actual capacity release and off-system sales benefits shall be accumulated for the April through March period each year. Washington Customers shall receive all benefits up to $5,000,000 on an annualized basis. During the period, the actual margins in excess of $5,000,000 shall be shared 50% to Customers and 50% to Avista Energy.
b. Actual Capacity Release margins shall be equal to the actual margin, allocable to the Washington jurisdiction, associated with the release of the Avista Utilities' (WA/ID Division) capacity on a transaction by transaction basis.
c. Actual Off-System Sales margins shall be calculated as the actual delivered volumes moved on the Avista Utilities' (WA/ID Division) transportation to off-system parties, multiplied by the difference between the published delivery point index price and the published receipt point index price for the relevant time period, e.g., daily or monthly, net of variable transportation and fuel charges. Washington Customers shall receive an allocated share based on a system contract demand allocator.

5. Administrative Cost Savings: Natural gas costs shall be reduced by the fixed Administrative Cost Savings benefit of $6,717 per month ($80,600 annually) until these cost savings are reflected in rates through a rate proceeding.

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6. The difference between the monthly Benchmark Mechanism costs, as described above, and the costs included in Customers' rates for the respective month shall be deferred to Account 191.31 for later refund or surcharge to Customers under Schedule 155 - Gas Rate Adjustment.

7. Contract Specific Operation Flow Order (OFO): As a result of various segmented capacity releases in the past, the Company is exposed to contract specific OFO's on Northwest Pipeline's system from the Jackson Prairie receipt point west to east through the Columbia River Gorge.

If contract specific OFO's are imposed on the Company from JP through the Columbia River Gorge that cause Avista Energy to schedule deliveries from points west of the Gorge on any day that exceed volumes calculated by the following formula then the Company will pay Avista Energy's actual daily cost of gas for such volumes:
((DSL – SSW) * BWP) + SSW. (Where DSL = daily system load, SSW = daily Synthetic Storage Withdrawal volume from Jackson Prairie Storage, BWP = basin weighting percentage from Sumas.)

If contract specific OFO's are called which would result in daily pricing Avista Energy will communicate with the Company on the impact and the Company may determine if it would be appropriate to satisfy the OFO with storage withdrawal and adjustments to forward synthetic storage schedules.

Issued November 7, 2001 Effective April 1, 2002

Issued by Avista Corporation
By Kelly O. Norwood, Vice Presi

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