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May 18, 2016

Via Electronic Mail

Steven V. King
Executive Director and Secretary
Washington Utilities & Transportation Commission
1300 S. Evergreen Park Drive S. W.
P.O. Box 47250
Olympia, Washington 98504-7250

Re: Docket No. UG-132019 - Inquiry into Local Distribution Companies' Natural Gas Hedging Practices and Transaction Reporting

Dear Mr. King,

Avista Corporation dba Avista Utilities (Avista or Company) submits the following comments in accordance with the Washington Utilities and Transportation Commission's (Commission) Notice of Opportunity to File Written Comments (Notice) issued in Docket UG-132019 dated April 11, 2016. Avista appreciates the opportunity to provide the following comments related to the issues identified by the Commission in its Notice.

1. Do you see benefits in a risk-management approach to hedging such as that presented in the White Paper as opposed to current hedging strategies used by utilities? Would the use of this methodology ultimately result in savings over traditional programmatic hedging to customers?

Yes, Avista does see potential benefits to using risk-management techniques to help manage its natural gas procurement plan. As we have previously stated in written comments in this Docket, the goal of Avista's Procurement Plan (Plan) is to provide reliable supply at competitive prices, with some level of price stability, in a volatile commodity market. To this end, the Plan has included hedging (on both a short-term and long-term basis) and index/spot market purchases. Hedging helps to mitigate natural gas price volatility by locking in prices for a portion of the portfolio in various time increments. The "benefits" from the Plan come in the form of reduced exposure to market volatility which is especially beneficial in a period of high price spikes. Avista believes that the effectiveness of the Plan may be improved with some combination of traditional programmatic hedging and additional quantitative financial hedging practices such as defensive hedging as discussed in Mr. Gettings' White Paper.

As noted in Avista's presentation given at the March 28, 2016 workshop, a new Position Report Model, which incorporates both programmatic and defensive hedging components, has been developed and is currently being evaluated. The prototype model includes all utility purchase and sale transactions, estimated customer load, and storage injections and withdrawals, to derive open positions (by basin) that are marked to forward market prices. These monthly financial positions along with market volatility are then used to calculate the Value at Risk (VaR) by basin, which in turn is used to evaluate the execution of defensive hedges. This model is running parallel to the current Plan which is based primarily on a combination of index purchase and traditional programmatic hedging. The final determination for implementation of changes to the Plan to incorporate defensive hedging will depend on a variety of factors including determination by Avista's internal Strategic Oversight Group (SOG) that such a change meets Plan goals, and approval of Avista's Risk Management Committee (RMC). As it relates to contingent hedging (discussed in the

White Paper), Avista is not considering that form of hedging at this time, however will continue to evaluate how it may be incorporated into the Plan in the future.

In terms of price/cost "savings", given that prices cannot be accurately predicted, the effectiveness of any plan will be directly impacted by market trends, and may or may not result in a lower cost than if the local distribution company (LDC) had not hedged at all. In some circumstances, a programmatic hedge program may result in costs averaging below spot market (such as when prices are rising) whereas in other circumstances a quantitative-based hedge program may result in average costs above the spot price (as would have been the case when prices started to fall earlier this decade).

2. If so, what are your current in-house capabilities to implement risk-management hedging practices of the kind proposed in the White Paper?

In response to question No. 1, Avista noted it is in the development and testing phase for a new Position Report Model that may incorporate some of the risk management techniques presented in the "White Paper". Once the development and testing phase is completed related to the new Position Report Model, it will be presented to the Risk Management Committee for approval. After all necessary approvals are received, the Company will begin the training process for in-house employees and finalize any software and reporting requirements. We anticipate the plan could potentially be implemented for the next Procurement Plan year (November 2017 – October 2018). Should there be a determination that modifications are required or if additional concepts in the White Paper (such as those outlined for contingent hedging) become a mandate, outside consulting services would likely be employed (such as third party expertise related to options trading).

In addition to this new model, during 2015 Avista internally developed and successfully implemented a quantitative-based Gas Storage Optimization Model. This model tracks historical spreads of various time frames for the Jackson Prairie Storage Facility (JP) injections and

withdrawals. This historical analysis quantifies the relative benefit of current forward prices and identifies optimal transactions to lock in more economic value than the previous programmatic (based on synthetic schedule) injection/withdrawal method. To date, the use of the Gas Storage Optimization Model has provided more value for customers as compared to the previous method.

It should be noted, however, that any change in the Plan must not only be approved by the Company's RMC but also be acceptable to all three natural gas jurisdictions Avista operates in. Due to the integrated nature of our systems and service territories, Avista uses one comprehensive natural gas Plan which is applicable to all jurisdictions.

3. What are the potential costs associated with adopting such a hedging program?

The potential costs which may be incurred by Avista in the implementation of the hedging program in its entirety would include labor costs, internal software development costs, external software (primarily due to contingent/option trades), third-party consultant fees, training costs, and reporting costs to name a few. Avista does not currently transact in the options market and does not have staff trained to do so. In order to transact in this market, software capable of options valuation and reporting would need to be researched and developed or purchased, and/or outside option trading services would need to be secured. Jurisdictional reporting requirements would also add an additional level of complexity to reporting requirements and would most certainly result in increased programming costs.

4. What transition period would be required to adopt such a program?

As noted in response to question No. 2, the model currently in development could potentially be implemented as early as November 2017. This timeframe is contingent upon final development/testing, SOG and RMC approval, training needs, and reporting requirements. The implementation timeframe would significantly increase should the Commission require all concepts

in the White Paper be deployed as a part of the Plan. As noted in the response to question No. 3, currently Avista does not transact in the options market and would not only incur additional expense to transact in this market, but would also need time to sufficiently evaluate alternatives. The benefits of such a strategy would also need to be thoroughly evaluated to compare with the potentially significant costs to implement. For Avista, we would also need to consider the input of the Idaho and Oregon Commissions and other interested stakeholders in those jurisdictions. A transition time of three to five years would be reasonable, assuming the utilities were required to deploy all of the components of the White Paper.

5. Given that several LDCs have operations in states that do not use a risk management approach to hedging, rather instead expect the use of programmatic hedging, what challenges does this Commission face in considering this situation in implementing a risk management approach to hedging?

While considering the expertise provided by Mr. Gettings in his White Paper, Avista was already developing a risk management approach towards hedging for the natural gas utility. The increased complexity implicit in the risk management strategies proposed in the White Paper could delay reaching a final solution acceptable to all jurisdictions. If Avista determined there was value to customers in implementing a defensive hedging strategy, we would work with the Idaho and Oregon Commissions and other stakeholders to explain any changes and solicit feedback with the goal of continuing to operate under a single Plan in all jurisdictions. Avista sees value in the management of all natural gas resources under one comprehensive Plan. Therefore, it is recommended that any policy issued by the UTC allow for flexibility and customization to fit the specific needs of each LDC.

6. How should companies assess the tolerance of customers for bill increases, due to commodity price volatility?

It is difficult to determine the customer tolerance level for bill increases in the context of a hedging strategy. As noted by Mr. Gettings:

> Customers derive greater value from upside cost mitigation than they forego from hedge losses because upside down cost outcomes tend to require them to make painful adjustments, but hedge losses, while still painful, occur in declining markets when the net costs are more favorable than prior expectations, thus moderating the pain.

The determination of the acceptability of the effects of additional hedging would likely be made with input from our SOG group, and would include the flexibility to adjust these levels in response to changes market conditions or other economic factors.

7. At his workshop presentation March 28, Mr. Gettings proposed that the Commission create a "rebuttable presumption" that hedging expenses were prudently incurred if a company adopted and faithfully executed a risk management hedging strategy. Can the Commission legally create such a presumption? If not, what sort of standard can the Commission offer to the gas LDCs that would mitigate against any future?

Prudent management is necessary, even when a plan is in place, because of changing market and economic conditions. In spite of current low prices and abundant supply forecasts, the natural gas market continues to be dynamic and volatile. It is the responsibility for the utility to make prudent decisions in its hedging program based on the information that is available at the time. The standard that the Commission should operate under should be the same as exists today; if a Company has a plan, is following its plan, communicates the plan and any changes to the Commission or Commission Staff, and is otherwise appropriately managing its business, then the LDC should be deemed as having acted prudently.

8. At the workshop, Mr. Gettings also proposed that utilities would file with the Commission a "Capability Blueprint" or similar hedging plan. By what standard would the Commission review such a filing? Could it acknowledge such a plan similar to how it reviews integrated resource plans? Should a "Capability Blueprint" be separate from a PGA filing or concurrent with it?

Avista believes the Commission should focus more on substance than form as it relates to creating a formal "Capability Blueprint". As a part of its annual Purchased Gas Cost Adjustment (PGA) filing, it should file with the Commission its Plan for the upcoming November – October time period. That Plan would include the various components the LDC will use to purchase natural gas, and how it will manage those transactions for the upcoming year. As noted in previous comments in this Docket, Avista already offers and or meets with Commission Staff twice per year – once in the Spring and once in the Fall. During those semi-annual updates, Avista provides information related market trends and analysis, storage balances, executed hedges and open hedges. Avista also provides information on future Plan changes. Annually during the PGA process, Staff and other parties are given the opportunity to review the executed hedges for the upcoming year as well as results of the previous year hedges. This process has worked well in the past and we see no reason to deviate from it. However, if Staff determines additional time is required for review, Avista would be willing to file its PGA earlier (perhaps August 1 like it does in Oregon). Avista would also be supportive of the Commission participating in semi-annual or quarterly update meetings.

9. What kind of communication with or reporting to the Commission on hedging strategies is appropriate?

Please see the response to question No. 8

10. If the Commission determines that the proposals in the White Paper set out a template for hedging best practices, should the Commission proceed with a non-binding policy statement on hedging, issue a CR-101 with intent to adopt a rule, or consider other possible procedures?

Avista recommends a non-binding policy statement which provides what the Commission believes are best practices related to hedging, but which allows for a certain level of discretion and flexibility so that the LDCs can customize its plan due to individual company goals and objectives. This format would provide the ability to establish flexible policies that can be adjusted to meet changing economic, regulatory and market conditions and aid in the development of policies applicable to all jurisdictions Avista operates in.

Avista appreciates the opportunity to work with Mr. Gettings and the learning opportunity provided within the White Paper. However, there is no hedge program that will definitively provide the most benefit in terms of cost savings and/or risk management. We want to be cognizant of the fact other industry experts may provide differing viewpoints which Avista may also consider. Any policy statement issued by the Commission should not preclude LDCs from considering and/or utilizing different approaches.

Again, the Company appreciates the opportunity to provide these comments. If you have any questions regarding these comments, please contact me at 509-495-8620 or at pat.ehrbar@avistacorp.com.

Sincerely,

Patrick Ehrbar
Senior Manager, Rates & Tariffs