BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of AVISTA CORPORATON, d/b/a AVISTA UTILITIES, For an Order Authorizing Implementation of a Natural Gas Decoupling Mechanism and to Record Accounting Entries Associated With the Mechanism.	)	DOCKET NO. UG-060518 SETTLEMENT AGREEMENT

I. PARTIES

1. This Settlement Agreement is entered into by Avista Corporation (the "Company"), the Staff of the Washington Utilities and Transportation Commission ("Staff"), the NW Energy Coalition ("the Coalition"), and Northwest Industrial Gas Users ("NWIGU"), jointly referred to herein as the "Signing Parties." The Public Counsel Section of the Washington Attorney General's Office and The Energy Project do not join in this Settlement. The Signing Parties agree this Settlement Agreement is in the public interest and should be accepted as a resolution of all issues in this docket. The Signing Parties understand this Settlement Agreement is subject to Commission approval.

II. INTRODUCTION

2. The Company filed a Petition, dated April 4, 2006, requesting the Commission to approve a proposed Natural Gas Decoupling Mechanism. The Company also provided a copy of the Petition to representatives of Public Counsel, the Northwest Industrial Gas Users, the Coalition, the Washington Energy Policy Group (Department of Community

Trade and Economic Development or "CTED") and the Spokane Neighborhood Action Program.

Workshops were held on May 17th and June 28th at the Commission's offices to discuss the Company's proposed Mechanism. Representatives of all of the aforementioned organizations were present, as well as a representative of The Energy Project. A number of different issues and alternatives were explored during these workshops. On August 7th, the Company filed an Amendment to its original Petition to address several issues raised by the other parties.

3. A prehearing conference was held on September 6, 2006, and the Coalition, NWIGU and The Energy Project were granted permission to intervene and participate along with Staff and Public Counsel.

4. After analysis of the filing, all parties commenced discussions for purposes of resolving or narrowing the contested issues in this proceeding in a settlement conference held October 16, 2006.

5. The Signing Parties have reached agreement on the issues in this proceeding and wish to present their agreement for the Commission's consideration. This Settlement is the product of discussions among all parties at the aforementioned workshops and settlement conferences. The Signing Parties believe that the Settlement will serve the broader interest of removing disincentives to engage in additional conservation. The Signing Parties therefore adopt the following Settlement Agreement in the interest of expediting the disposition of this proceeding.

III. AGREEMENT

6. The Signing Parties have agreed that the company's Decoupling Mechanism (hereinafter "Mechanism") shall consist of the following:

A. Term of Pilot Program: The implementation of the Mechanism will begin January 1, 2007, whereupon deferred revenue entries would begin being recorded for that month. The proposed term of the Mechanism is 2 years and 6 months for the recording of deferred revenue (January 2007 – June 2009). However, the proposed amortization period would be three years, beginning on November 1, 2007 and ending on October 31, 2010.

B. Application of the Mechanism: The Mechanism would apply only to customers under the Company's natural gas Schedule 101.

C. Calculation of Monthly Deferral Amount: Following the end of each month, the actual volume of weather-corrected therm sales for the calendar month (Current Therm Sales) will be determined and compared with the weather-corrected therm sales for the corresponding month from 2004 (Base Therm Sales), the Company's most recent test year.

(1.) Adjustment for New Customer Usage – Prior to weather-correcting actual therm sales for the month, an adjustment will be made to remove the usage associated with new customers added since the corresponding month of the test year. To the extent the Company has added customers since the test year, these new customers would increase Current Therm Sales as compared to the Base Therm Sales. The actual usage for new customers will be subtracted from the total current month usage.

(2.) Adjustment to Weather-Correct New Usage - Following the subtraction of usage for new customers, the net current month usage will be weather-corrected. The coefficients (usage per degree-day per customer) used to determine the weather adjustment will be the same as those used in the test year, thereby providing a true comparison of the usage between the two periods.

(3.) Comparison of Usage Between Current Month and Test Year – Following the adjustments for new customer usage and weather, the net Current Therm Sales for the month will be compared with the Base Therm Sales to determine the difference in therm sales. This comparison captures the effect of conservation and price elasticity for "existing" customers since the corresponding month of the test year.

(4.) Over/Under-Recovery of Margin Resulting From Usage Differences – The difference in usage will then be multiplied by the approved margin rate for Schedule 101 (sales rate less purchased gas cost per therm) to calculate the fixed distribution costs that are either under-recovered or over-recovered, as compared to the test year.

(5.) Ninety Percent (90%) of Margin Difference Deferred – Ninety percent (90%) of the margin difference, either positive or negative, will be deferred and recorded in a separate account for later recovery (or rebate).

(6.) Effect of Intervening General Rate Case - If the Company files a natural gas general rate filing and the Commission issues its Order in that filing prior to June 30, 2009, the Base Therm Sales and margins resulting from that filing will be used in the Monthly Revenue Deferral Calculation for the remaining

months of the pilot term. Any weather adjustment approved in that filing would be used for determining the Base Therm Sales and Current Therm Sales. The authorized rate of return in that filing would be used for the prospective application of the earnings test, as set forth below in Section E.(1.).

D. Rate Adjustments Coincident with Annual PGA: The monthly deferred revenue will be accumulated through June of each year during the term of the Mechanism. If the Mechanism is approved to be effective January 1, 2007, the Company will accumulate the monthly deferred revenue for January through June 2007. It will then file a request to implement a rate adjustment, coincident with the 2007 PGA rate adjustment, to amortize that deferred balance over a twelve-month period, subject to the "earnings" and "DSM" tests described below. For each of the two successive years, the Company will accumulate the deferred revenue for each July-June period, and file a request on or before September 1 to implement the appropriate rate adjustment coincident with the annual PGA. Interest would be accrued on the deferred balance at the same rate applied to the Company's PGA deferral account.

E. Deferred Revenue Recovery Subject to Earnings and DSM Tests: The level of deferred revenue recovery will be subject to (a) an annual earnings test, and (b) a DSM test. The tests will be calculated independently and the test resulting in the lowest surcharge amount would be used.

(1.) Application of Earnings Test - The "earnings-test" will be based on the Company's annual "Commission-basis" operating results, which are filed with the Commission by April 30 for the previous calendar year results. If the Commission-basis rate of return for the Company's Washington gas operations exceeds 9.11%, it would reduce the amount of the proposed surcharge (amount

transferred to the balancing account) to bring the rate of return down to 9.11%. (The authorized rate of return of 9.11% is derived from the Commission's Order No. 05 in Docket No. UG-050483.) If removing the entire deferred revenue amount from the Commission-basis results does not reduce the rate of return to 9.11%, no surcharge would be implemented. Where the amount of the surcharge is reduced as a result of the earnings test, the amount of deferred revenue remaining (not recovered through the surcharge) will be carried forward and used to offset future deferrals that would otherwise be recorded, rather than written off the Company's books. (See Attachment 1 for illustration of Earnings Test)

(2.) Application of DSM Test – The "DSM test" relates to the Company achieving pre-established natural gas DSM target savings during the prior year. The Company's 2006 Integrated Resource Plan (IRP) sets forth a natural gas (Washington & Idaho) target savings level of 1,062,000 therms for each of the calendar years 2006 and 2007.[1] This target savings level for each year will be used for determining the level of the 2007 and 2008 surcharges; the target savings level included in the Company's 2008 IRP will be used for the 2009 surcharge. The Company will file its 2008 gas DSM goal as a tariff revision to its decoupling tariff, which will provide an opportunity for review and comment from all interested parties. The following table shows the level of the surcharge (as a percentage of the margin difference between the current year and the test year) based on the actual gas DSM savings compared to the pre-established IRP target:

[1] The expected cost to achieve this savings target is $2.5 million for 2006 and $3 million for 2007.

Actual vs Target DSM Savings	Surcharge vs Margin Difference
< 70%	0%
≥ 70% and <80%	60%
≥ 80% and < 90%	70%
≥ 90% and < 100%	80%
≥ 100%	90% (amount deferred)

If less than 70% of the target savings are achieved, the surcharge amount will be zero. DSM savings achieved between 70% and 100% of the target will result in the corresponding surcharge level shown in the above table. Any deferred revenue that cannot be recovered through a surcharge as a result of not meeting at least 100% of the DSM target will be carried forward and used to offset future deferrals that would otherwise be recorded. (See Attachment 2 for illustration of DSM Test)

F. Independent Third Party Review of DSM Savings: The Company will retain an independent third party to audit the results of DSM savings reported for decoupling purposes. This independent auditor will be chosen through an "RFP" process reviewed and approved by the parties to this Settlement Agreement. The scope of the audit will include an appropriate sampling of projects to verify the work completed, the savings recorded, and a review of the engineering estimates used to estimate the savings.

The cost of the audit will be funded through DSM tariff rider funds and will not exceed $35,000 per year. (The Company will change the present method of recognizing DSM savings for decoupling reporting purposes to one where all savings associated with a project are recognized at the time the entire project is completed in order to reduce the cost of the audit, and for purposes of applying the DSM test in Section E.(2) above.)

G. Annual Two Percent (2%) Rate Change Limitation: After applying the "earnings" and "DSM" tests, the amount of the rate increase resulting from the adjustment will be subject to an annual incremental limit of 2%, i.e., the annual increase in the surcharge cannot exceed a 2% rate increase each year (cumulative of 6% over the initial term). The incremental surcharge (percentage) increase will be determined by subtracting the annual revenue amount recovered by the present surcharge rate from deferred revenue to be recovered through the proposed surcharge rate, and dividing that net amount by the total "normalized" revenue for Schedule 101 for the most recent July – June period. The normalized revenue would be determined by multiplying the weather-corrected usage for the period by the present rates in effect. If the incremental surcharge would exceed a 2% rate increase, only a 2% increase would be implemented and any excess deferred revenue will remain in the deferred revenue account and could be recovered the following year, subject to the 2% limitation.

H. Annual Decoupling Rate Adjustment Filing: On or before September 1, 2007, the Company will file a proposed decoupling surcharge (or rebate) based on the amount of deferred revenue recorded for the prior January through June 2007 period. For the September 2008 and 2009 filings, the proposed rate adjustment would reflect the total deferred revenue for an entire year (July-June). The results of the "earnings", "DSM" and "2%" tests will be included with the filing and used to determine the amount of the

rate adjustment. A proposed tariff will be included in those filings. A sample tariff for the decoupling rate adjustment is attached for illustrative purposes as Attachment 3. The Company presently files its Commission-Basis Earnings report (for the prior year) by April 30th and will file its DSM report in advance of the decoupling filing.

The proposed tariff will reflect a rate adjustment that would recover the deferred revenue amount over a twelve-month period to be implemented coincident with the Company's annual PGA. If the rate adjustment is approved by the Commission, the deferred revenue amount approved for recovery or rebate will be transferred to a balancing account and the revenue surcharged or rebated during the period will reduce the deferred revenue in the balancing account. Any deferred revenue remaining in the balancing account at the end of the year, resulting from over- or under-collection, will be added to the new revenue deferrals to determine the amount of the proposed surcharge for the following year.

I. Accounting and Quarterly Reporting for the Mechanism: The Company will record the deferred revenue in account 186 – Miscellaneous Deferred Debits. The amount approved for recovery will be transferred into a 182.3 - Regulatory Asset account for amortization of the surcharge revenue received. On the income statement, the Company would record both the deferred revenue and the amortization of the deferred revenue through Account 407 - Regulatory Debits and Credits, in separate sub-accounts. The Company will file a quarterly report with the Commission showing pertinent information regarding the Mechanism. This information will include a spreadsheet showing the monthly revenue deferral calculation for each month of the current deferral period (July – most recent month), as well as the current and historical monthly balance in the deferral account.

J. Evaluation Plan and Extension of Mechanism: On or before March 31, 2009 (three months prior to the end of the pilot deferral term), the Company may file a request to continue the Mechanism beyond its initial term. That filing would include an evaluation of the Mechanism and any proposed modifications of the Company. Any party is free to argue that the renewal of the Mechanism is only appropriate in the context of a general rate case. The Company would bear the burden of demonstrating why the pilot program should be extended other than in the context of a general rate case.

The Company, Commission Staff, and other interested parties will develop, through a collaborative process, a draft evaluation plan to be filed with the Commission no later than December 31, 2007.

IV. EFFECT OF THE SETTLEMENT AGREEMENT AND PROCEDURE

7. Binding on Parties. The Signing Parties agree to support the terms of the Settlement Agreement throughout this proceeding, including any appeal, and recommend that the Commission issue an order adopting the Settlement Agreement contained herein. The Signing Parties understand that this Settlement Agreement is subject to Commission approval. The Signing Parties agree that this Settlement Agreement represents a compromise in the positions of the Signing Parties. As such, conduct, statements and documents disclosed in the negotiation of this Settlement Agreement shall not be admissible evidence in this or any other proceeding.

8. Integrated Terms of Settlement. The Signing Parties have negotiated this Settlement Agreement as an integrated document. Accordingly, the Signing Parties recommend that the Commission adopt this Settlement Agreement in its entirety. Each

Signing Party has participated in the drafting of this Settlement Agreement, so it should not be construed in favor of, or against, any particular Party.

9. Procedure. The Signing Parties shall cooperate in submitting this Settlement Agreement promptly to the Commission for acceptance. The Signing Parties shall make available a witness or representative in support of this Settlement Agreement. The Signing Parties agree to cooperate, in good faith, in the development of such other information as may be necessary to support and explain the basis of this Settlement Agreement and to supplement the record accordingly.

The Signing Parties agree to stipulate into evidence the prefiled direct testimony and exhibits of the Company, together with such evidence in support of the Agreement as may be offered at the time of the hearing on the Settlement. If the Commission rejects all or any material portion of this Settlement Agreement, or adds additional material conditions, each Signing Party reserves the right, upon written notice to the Commission and all parties to this proceeding within seven (7) days of the date of the Commission's Order, to withdraw from the Settlement Agreement. If any Signing Party exercises its right of withdrawal, this Settlement Agreement shall be void and of no effect, and the Signing Parties will support a joint motion for an expedited procedural schedule to address the issues that would otherwise have been settled herein.

10. No Precedent. The Signing Parties enter into this Settlement Agreement to avoid further expense, uncertainty, and delay. By executing this Settlement Agreement, no Signing Party shall be deemed to have accepted or consented to the facts, principles, methods or theories employed in arriving at the Settlement Agreement, and except to the extent expressly set forth in the Settlement Agreement no Signing Party shall be deemed

to have agreed that such a Settlement Agreement is appropriate for resolving any issues in any other proceeding.

11 Public Interest. The Signing Parties agree that this Settlement Agreement is in the public interest and results in rates which are fair, just, reasonable and sufficient.

12. Execution. This Settlement Agreement may be executed by the Signing Parties in several counterparts and as executed shall constitute one agreement.

Entered into this 27th day of October, 2006

Company: By: _____

David J. Meyer
VP, Chief Counsel for Regulatory and
Governmental Affairs

Staff: By: _____

Gregory J. Trautman
Assistant Attorney General
Counsel for Commission Staff

The NW Energy Coalition By: _____
Nancy Glaser
The NW Energy Coalition

Northwest Industrial
Gas Users By: _____
Edward A. Finklea
Cable, Huston, Benedict, Haagenson &
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