



**Avista Corp.**

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January 10, 2014

***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 December 18, 2013. Avista appreciates the opportunity to provide the following comments related to the issues identified by the Commission in its Notice.

**1) Hedging Activities**

**a) What is the purpose of hedging?**

- i) Reduction in price volatility allowing greater cash-flow certainty?**
- ii) Protection against the substantial rate hikes?**
- iii) Stabilization of customer rates, especially during the winter months?**
- iv) Other reasons?**

While Avista cannot accurately predict future natural gas prices, market conditions, supply and demand fundamentals, and experience help shape our overall procurement approach. The Company's goal is to provide reliable supply with a certain level of price stability in a volatile commodity market. To that end, the Company utilizes a Procurement Plan which includes hedging (on both a short-term and long-term basis), storage utilization, and index purchases. This approach is diversified by time, component, counterparty, and supply basin. The Procurement Plan is disciplined, yet flexible, and layers in fixed-price purchases to provide price certainty to customers. A copy of the Company's Natural Gas Procurement Plan is included as an exhibit in Avista's Energy Resources Risk Policy, and is approved on an annual basis by the Company's Risk Management Committee.

Avista believes that the primary purpose of hedging is to layer in fixed-price purchases to provide a level of price certainty for customers. While this may provide for greater cash-flow certainty as a byproduct, that is not a driver. Avista believes that the PGA process itself reduces price volatility, protects against substantial rate hikes (or decreases) and stabilizes customer rates during the plan year. Longer term hedging products can also mitigate overall rate volatility to customers between PGA years.

**b) Who should be the beneficiaries of hedging?**

The Company's goal as it relates to natural gas procurement, and hedging in particular, is to provide customers with reliable natural gas supply with a level of price certainty in a volatile commodity market. Customers are the beneficiaries of a utility hedging program that is a component of a well-defined, structured and communicated Procurement Plan.

**c) Hedges are commonly negotiated for a fixed period of time; the time period can span from months to years.**

**i) Is there a sound reason to limit the time horizon that companies can contract for a hedge?**

**ii) If so, what should be the maximum time horizon?**

**iii) What are the advantages, if any, of hedging over a multi-year period?**

Avista believes there should not be a limit to the time horizon that companies can contract for a hedge. Decisions related to the time horizon should be left to management's judgment. Factors such as market liquidity, demand forecasts, price and volume volatility, resource mix, economic factors, and price forecasts are all items that the Company reviews on a continuous basis and are items which help to inform the annual natural gas Procurement Plan. Advantages to hedging over a multi-year period could help to mitigate customer rate volatility between PGA years and dampen PGA and deferral account impacts.

- d) Companies normally hedge to a set “target” percentage of their expected load allowing the remainder of the unhedged load to be acquired on the spot market.**
- i) Is there a need for the Commission to limit the percent of load hedged and, if so, what should be the maximum percent hedged?**
  - ii) What are some of the factors affecting the amount of hedging that a utility should do?**
  - iii) When discussing target percentages, should the Commission distinguish between physical and financial hedging?**

The amount hedged should be determined on an annual basis by Company management during the development of the Procurement Plan, and should not be limited by a Commission rule. Further analysis of hedge percentages should be applied against load requirements on a monthly basis to ensure hedged percentages do not exceed requirements. In no instances should a utility hedge more than 100% of its forecasted load requirement. As discussed in the Company’s comments to Question C above, the factors that can affect the amount of hedging a utility should do includes market liquidity, demand forecasts, price and volume volatility, resource mix, economic factors, and price forecasts.

The Commission should not distinguish between physical and financial hedging. If done properly, all financial hedges should be associated with a physical index priced transaction, thus equalizing the physical and economic effects of both physical and financial hedges. Avista will financially hedge some of its load with fixed-price transactions, either with fixed-price physical purchases or with financial swaps [or futures] matched to purchases of index-priced physical products. Financial hedging is one of the tools available to Avista to create a fixed priced component for incorporation into the gas supply portfolio. The objective of using financial transactions for hedging is to increase market liquidity by introducing more potential participants to the transaction and thus providing the opportunity to acquire the supply at the lowest price available. The ultimate outcome provides price transparency leading to transactions at a lower price.

- e) Should the Commission consider providing an incentive mechanism allowing for sharing of gains as well as losses associated with a company’s hedging practices?**
- i) What should be the benchmark?**
  - ii) What are the challenges in developing an incentive mechanism?**

No, an incentive mechanism should not be employed. While Avista utilizes a Procurement Plan for purchasing natural gas for its customers, the Company is a “price taker” in that market forces outside of the Company’s control drive natural gas prices. As

such, while the Company strives to procure natural gas at competitive prices, market fluctuations could cause the Company's actual cost of gas to vary substantially from the embedded cost of gas. Because the Company cannot predict future market prices, there is essentially no opportunity for Avista to benefit from an incentive mechanism related to hedging, i.e., the Company realistically cannot design a hedging program to "beat the market." The primary purpose of a hedging program is to provide a certain level of price stability for customers over time, not to attempt to beat the market.

**f) Is it feasible to develop a financial model that would provide a benchmark the Commission could use as a "safe harbor" when evaluating a company's hedging performance?**

Due to the individual nature and characteristics of each utility, e.g., access to supply basins, available storage, etc., it would be difficult to develop a "one size fits all" benchmark for comparisons. Avista believes that the Commission should rely on its own authority and prudence standard to review the hedging decisions made by the Company at the time the hedges were entered into, and whether those decisions were consistent with the Procurement Plan and Risk Management Policy in effect at that time.

**i) Assuming the Commission decides to establish requirements or set limitations on hedging, as discussed above, by what means should the Commission act?**

- (1) Rule,**
- (2) Order applicable to all companies following a hearing,**
- (3) Company-specific orders after individual hearings,**
- (4) Non-binding policy statement,**
- (5) Other**

Avista believes formal requirements related to hedging activities should not be prescribed. However, the Company believes that the Commission could provide general guidance on its view related to hedging and could do so through a non-binding Policy Statement.

- 2) Purchased Gas Adjustment Mechanism (PGA) - WAC 480-90-233**  
**Although purchased gas costs include costs beyond hedging costs, hedging gains and losses can make up a material portion of the associated rate adjustment. The Commission believes it is important as part of this inquiry to examine certain aspects of the PGA filing requirements as they relate to hedging.**

- a) **Washington companies file adjustments to their PGA mechanisms annually. However, some stakeholders have suggested that annual filings fail to provide proper economic signals to consumers and may actually contribute to large swings in rates due to the accumulation of under- recovered or over-recovered amounts.**
- i) **Should the Commission require more frequent PGA filings, such as semi-annually, quarterly or even monthly?**
  - ii) **If companies make more frequent [PGA filings], to what extent should the companies provide additional supporting data and narrative above those already provided in its annual filing? (Please address the additional resources that the Commission may require to process the additional filings.)**

Avista supports the current PGA process which provides for Staff and Commission review and approval of the current year's natural gas costs (deferral account) and the subsequent year's projected gas costs (PGA). Per WAC 480-90-233, a Deferral Report is sent to Staff monthly, and is available for all parties to review the ongoing current year status prior to the filing of the annual PGA. When the annual PGA filing is made, it consists of the support and documentation for the Company's existing supply obligations and proposed forward looking commodity and transportation costs, as well as for the prior period amortization of those same PGA components, all of which is available for review by Staff, Public Counsel, and other interested parties.

Should the Commission desire the utilities to file more often, the Company believes that the current PGA process with the November 1 effective date should serve as a master PGA filing. That filing would seek approval of the current year's natural gas cost deferral account and the subsequent year's projected natural gas costs. Any other filing that occurs outside of the regular annual PGA should be prescriptive in nature, such as the updating of forward-index prices for unhedged volumes, so as to minimize potential preparation and review impacts to Staff, Public Counsel, the Company and other parties. A simplified format, in the Company's view, should alleviate the need for additional resources needed by the Commission. One option that the Commission could consider is a requirement for a utility to file an out-of-cycle PGA should the actual weighted average cost of gas materially differ from the embedded rate. The State of Idaho has such a requirement for its natural gas utilities.

- b) **Should the Commission consider a uniform PGA reporting standard allowing for:**
- i) **Comparability of data?**
  - ii) **Staff effectiveness and efficiency?**

Avista is supportive of a uniform PGA reporting standard that would allow for the comparability of data. In Oregon, for example, Commission Staff developed several standard worksheets that each of the natural gas utilities provide in their annual PGA filings. This standardization, we believe, allows for the comparability of data, and provides for a higher level of staff efficiency.

Again, the Company appreciates the opportunity to provide these comments and we look forward to participating in the workshop scheduled for January 23, 2014. If you have any questions regarding these comments, please contact me at 509-495-8620 or at [pat.ehrbar@avistacorp.com](mailto:pat.ehrbar@avistacorp.com).

Sincerely,

A handwritten signature in black ink that reads "Patrick Ehrbar". The signature is written in a cursive style with a large initial "P" and a long horizontal stroke at the end.

Patrick Ehrbar  
Manager, Rates & Tariffs