

**PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: August 20, 2002**

**REGULAR**   X   **CONSENT**        **EFFECTIVE DATE**       August 21, 2002      

**DATE:** August 13, 2002

**TO:** John Savage through Lee Sparling and Bonnie Tatom

**FROM:** Ray Nuñez

**SUBJECT:** AVISTA UTILITIES: (Advice No. 02-10-G) Requests approval of a special contract between Avista Utilities and Murphy Plywood.

**STAFF RECOMMENDATION:**

Staff recommends that the Commission approve Avista's proposed contract and related tariff sheets as filed.

**DISCUSSION:**

On July 2, 2002, Avista Corporation filed tariff sheets relating to a special contract for local transportation service to Murphy Plywood's manufacturing plant located in Sutherlin, Oregon. The plant is located approximately two miles from Northwest Pipeline. Because of the close proximity to the pipeline, Murphy Plywood can easily bypass Avista's distribution system. This special contract seeks to avoid this possible bypass. The special contract has a primary term of 10 years, however, the primary term will reinitiate following Avista's installation of additional gas facilities (described below) and thereafter will evergreen from year to year. Either party can cancel the contract with at least twelve months written notice prior to the end of the primary term or any subsequent anniversary date. The special contract explicitly provides that Avista will be the exclusive provider of local gas transportation to the plywood plant and that Murphy Plywood shall not enter into any bypass agreements or arrangements from any other pipeline supplier.

Murphy Plywood has used natural gas to produce plywood since 1966. The plant has not been significantly affected by economic cycles and as a result has been a steady producer of plywood. The overall demand for plywood products necessitates an expansion of the plant's production by adding two new natural gas dryers. Murphy Plywood has recently completed the building that will house the new dryers. Based on

the last two years of therm usage, the expansion will increase Murphy Plywood's gas consumption by 50%.

Currently, Murphy Plywood consumes 3 million therms per year with an average rate paid to Avista under Schedule 456 of approximately 7.9 cents per therm. The resulting margin revenue has been about \$237,000 per year. Upon adding the new gas dryers, consumption will rise to about 4.5 million therms per year. As part of Murphy Plywood's long-range planning for this plant, a co-generation unit could possibly increase gas consumption to over 7.5 million therms per year. However, the co-generation unit is conceptual at this juncture and therefore is not included in the analysis of the proposed special contract.

In order to effectively compete with a two-mile bypass pipeline, Avista has proposed a special transportation/distribution contract with the following provisions:

- the proposed rates for natural gas transportation are 2.75 cents per therm for the first 3.0 million therms per year delivered to the plant, 2 cents per therm for the next 1.6 million therms per year and 1 cent per therm for all therms delivered in excess of 4.6 million therms per year (the resulting annual margin revenue will be between \$82,500 and \$114,500),
- an annual minimum charge of \$55,000 per year based on a minimum usage of 2 million therms, and if Avista installs additional distribution facilities to serve the new gas dryer load, the minimum charge increases to \$75,000 per year along with an extension of the term of the contract for a 10-year period based on the in-service date of the additional distribution facilities,
- a reduction in the annual minimum charge on a pro rata basis for curtailment of gas, force majeure or a reduction in production at the plant of 15% or more, and
- a minimum payment provision that guarantees Avista collects the cost of any additional distribution facilities from Murphy Plywood.

ORS 757.230 and Commission Order No. 87-402 provide six standards that must be considered in offering special rates to meet the competition of an energy price or service alternative. These include:

1. Whether the rate generates revenues at least sufficient to cover relevant short- and long-run costs of the utility during the term of the rates.

During the first few years, the estimated annual margin revenue is \$82,500 based on estimated usage of 3 million therms at a rate of 2.75 cents per therm. With the expected gas dryer expansion, the estimated annual margin revenue increases to \$114,500 based on an annual volume of 4.6 million therms and all volumes in

excess of 4.6 million therms priced at 1 cent per therm. Therefore, the transportation charges cover relevant short-term costs. However, since additional distribution facilities are necessary to provide service for the new dryers, the transportation charges must also cover the long-run costs of any facility investment. Avista needs to build a one-mile four-inch pipeline and rebuild the existing regulator station to serve the customer's additional load, with the total cost estimated to be \$250,000. The levelized annual revenue requirement associated with this investment is \$61,500 per year over the ten-year contract term. The levelized amount of the annual minimum charge is \$93,100 per year, which more than covers the cost of Avista's investment. Also, additional coverage protection is included in the contract. If a contract termination occurs during the first ten years, Avista would recover its facilities investment from the minimum payment provision referred to above.

2. Whether the rate generates revenues sufficient to ensure just and reasonable rates are established for the remaining customers of the utility.

The utility's remaining customers will benefit based on the projected margins generated by the plant, as discussed in the first standard above. By keeping Murphy Plywood on Avista's system, contribution to Avista's fixed costs would continue as opposed to losing that contribution entirely. Further, other customers are protected from unforeseen events under the contract by the annual minimum charge and the minimum payment provision should the plywood plant unexpectedly shut down.

3. Whether it is appropriate to incorporate interruption of service in the utility's rate agreement with the customer.

Avista is not responsible for Murphy Plywood's gas supplies or interstate pipeline transportation. Murphy Plywood will be provided a level of service as reflected in Avista's Rule No. 21-Transportation of Customer-Owned Gas. Murphy Plywood will be interrupted, curtailed or entitled prior to other transportation customers paying higher rates for similar service. Murphy Plywood has alternate fuel capability (hog fuel) for half of its natural gas dryers. In the event of curtailment, Murphy Plywood may exercise its option to reduce its production and operate with fewer natural gas dryers.

4. Whether the rate agreement requires the utility to acquire new resources to serve the load.

Murphy Plywood will purchase and arrange its own gas supplies and transportation on Northwest Pipeline, and Avista is not required to arrange for gas supplies or

pipeline transportation on Murphy's behalf. As mentioned above in the first standard, Avista proposes to construct a one-mile distribution line and rebuild a regulator station for \$250,000. Estimated revenues more than cover the investment cost. Since the transportation service provided is interruptible, no additional transport resources will be required other than the distribution line and regulator station. The annual minimum charge ensures investment cost coverage in the unlikely event the plywood plant shuts down.

5. The rate for discretionary customers must be designed to maximize contributions from customers receiving the discount.

The contract acts to maximize the revenues collected by competing with the cost of a two-mile bypass. Avista will receive revenues sufficient to cover short-term costs and long-run investment costs during the contract period. The discount from tariff rates (approximately 52%) is reasonable because of the competitive cost and construction characteristics of the bypass pipeline. Murphy Plywood relies on ARB Inc., the largest pipeline contractor company in the western United States for its construction estimates and Avista was able to independently confirm these estimates for purposes of negotiations. Staff review of the bypass cost indicates that the proposed special contract revenues achieve coverage of the bypass investment. Even though there were tough negotiations, Avista was able to arrive at a mutually agreeable rate and retain this customer at an acceptable margin.

6. The rate must be open-ended and made available to any customer meeting the criteria for the class.

Avista agrees to offer this rate to other similarly-situated customers. The class of customers to be served under this agreement is defined as limited to those customers that:

- are large-use customers that are within reasonable proximity to one of the company's pipeline transporters,
- have demonstrated that it is more economic to take service directly from the pipeline transporter rather than take service from Avista under its filed tariff rates,
- have the ability and financial resources to construct facilities which would allow for service directly from the interstate pipeline,
- are willing to be interrupted prior to other customers paying a higher rate for similar service, and
- are willing to accept all other provisions of the agreement.

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**PROPOSED COMMISSION MOTION:**

Avista's Special Firm Transportation Service Agreement with the Murphy Plywood Corporation in Advice 02-10-G be allowed to go into effect on August 21, 2002.

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