

Avista Corp.  
1411 East Mission PO Box 3727  
Spokane, Washington 99220-3727  
Telephone 509-489-0500  
Toll Free 800-727-9170

RECEIVED

2007 JAN -9 AM 10: 03

IDAHO PUBLIC  
UTILITIES COMMISSION



Corp.

January 8, 2007

State of Idaho  
Idaho Public Utilities Commission  
Statehouse  
Boise, ID 83720

Attention: Ms. Jean Jewell, Secretary

RE: Avista Corporate Reorganization to Create a Holding Company;  
Case Nos. AVU-E-06-1 and AVU-G-06-1

Pursuant to Order No. 30091, in case Nos. AVU-E-06-1 and AVU-G-06-1, enclosed for filing with the Commission are an original and seven copies of the Settlement Stipulation, Narrative In Support of Settlement Stipulation and Appendix A Commitments And Conditions, for Avista Corporation's Reorganization Proposal filed with the Washington Utilities and Transportation Commission (WUTC) in Docket No. UE-060273 on January 5, 2007. These documents are still subject to the approval of the WUTC.

This filing is in compliance with the requirement that a copy of any stipulation reached in another jurisdiction, regarding Avista's corporate reorganization proposal to create a holding company, be provided to the Commission and other parties within 5 calendar days.

Please direct any questions regarding this filing to Liz Andrews at (509) 495-8601.

Sincerely,

A handwritten signature in black ink that reads "Kelly Norwood". The signature is written in a cursive, flowing style.

Kelly Norwood  
Vice President, State and Federal Regulation

Enclosures



Rob McKenna

# ATTORNEY GENERAL OF WASHINGTON

Utilities and Transportation Division

1400 S Evergreen Park Drive SW • PO Box 40128 • Olympia WA 98504-0128 • (360) 664-1183

January 5, 2007

RECEIVED  
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IDAWA PUBLIC  
UTILITIES COMMISSION

Carole J. Washburn, Secretary  
Washington Utilities and Transportation Commission  
1300 S. Evergreen Park Dr. SW  
P. O. Box 47250  
Olympia, Washington 98504-7250

Re: *Avista Reorganization*  
Docket No. UE-060273

Dear Ms. Washburn:

Enclosed for filing are an original and seven copies of a Settlement Stipulation (with Appendix A, entitled "Commitments and Conditions"), a Narrative in Support of Settlement Stipulation, and Certificate of Service.

The settlement is signed by Avista, Staff and Public Counsel. *Settlement Stipulation at ¶2.* While the settlement is not unanimous, the other parties to this docket, ICNU and NWIGU, do not oppose the settlement. *Id. at ¶3.*

Pursuant to Paragraph 13 of the Settlement Stipulation, we request that the Commission suspend the existing procedural schedule in this docket, and schedule hearing dates to review the proposed settlement.

Sincerely,

DONALD T. TROTTER  
Senior Counsel

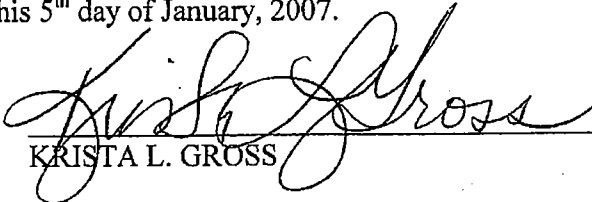
DTT:klg  
Enclosure  
cc: Parties



Docket No. U-060273  
CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing documents upon the persons and entities listed on the Service List below by depositing a copy of said document in the United States mail, addressed as shown on said Service List, with first class postage prepaid.

DATED at Olympia, Washington this 5<sup>th</sup> day of January, 2007.

  
KRISTA L. GROSS

**Receive Confidential:**

*For Avista Corporation:*

David Meyer  
Avista Corporation  
PO Box 3727  
Spokane WA 99220-3727  
Phone: (509) 495-4316  
Fax: (509) 495-4361  
E-Mail: [dmeyer@avistacorp.com](mailto:dmeyer@avistacorp.com)

*For Public Counsel:*

Judy Krebs  
Public Counsel Section  
Attorney General's Office  
800 Fifth Avenue, Suite 2000  
Seattle, WA 98104-3188  
Phone: (206) 464-6595  
Fax: (206) 289-2079  
E-mail: [judyk@atg.wa.gov](mailto:judyk@atg.wa.gov)

*For ICNU:*

Matthew Perkins  
Davison Van Cleve  
333 SW Taylor #400  
Portland OR 97204  
Phone (503) 241-7242  
Fax (503) 241-8160  
E-mail: [mail@dvclaw.com](mailto:mail@dvclaw.com)

**Receive Non-Confidential Only:**

*For NWIGU:*

Edward A. Finklea  
Chad Stokes  
Cable Huston Benedict  
1001 SW Fifth Ave #2000  
Portland, OR 97204-1136  
Phone: (503) 224-3092  
Fax: (503) 224-3176  
E-mail: [efinklea@chbh.com](mailto:efinklea@chbh.com)  
[cstokes@chbh.com](mailto:cstokes@chbh.com)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of Avista Corporation d/b/a Avista Utilities for an Order Approving a Corporate Reorganization To Create a Holding Company, AVA Formation Corp.

DOCKET UE-060273

SETTLEMENT STIPULATION

**I. OVERVIEW**

**A. The Stipulation resolves all issues and should be approved**

1           The Parties to this Settlement Stipulation agree that it represents a fair, just and reasonable compromise of the issues raised in this proceeding, that this Settlement Stipulation (“Stipulation”) is in the public interest, and it satisfies the Commission’s “no harm to ratepayers” policy. The Parties further agree that the Commission should approve this Stipulation with no material changes, in resolution of all issues in this docket. Therefore, the Parties recommend the Commission approve Avista’s Application for reorganization under the terms set forth in this Stipulation. The Parties understand this Stipulation is subject to Commission approval.

**B. Parties to the Stipulation**

2           This Stipulation is entered into, by and between Commission Staff, Avista Corporation, doing business as Avista Utilities (“Avista”), and the Public Counsel Section of the Attorney General’s Office (“Public Counsel”).

3           The other parties to this docket are Intervenors Northwest Industrial Gas Users (NWIGU) and the Industrial Customers of Northwest Utilities (ICNU), who are not

signatories. However, NWIGU's counsel (Mr. Finklea) and ICNU's counsel, Mr. Perkins, respectively advised Commission counsel (Mr. Trotter) that NWIGU and ICNU neither support nor oppose this Stipulation. Consequently, this is a multiparty settlement, as that term is defined in WAC 480-07-730(3). *Stip.* ¶ 3.

**C. Documents comprising the Stipulation**

4 The Stipulation consists of this document entitled "Settlement Stipulation" and Appendix A attached hereto, entitled "Commitments and Conditions."

**II. NATURE OF AVISTA'S APPLICATION**

5 On February 16, 2006, Avista filed its "Application of Avista Corporation" ("Application") with the Commission, seeking an order authorizing Avista to conduct a corporate reorganization, including the formation of a holding company to be known as AVA Formation Corp (hereinafter referred to as the "Reorganization"). This Commission has jurisdiction over such request pursuant to RCW 80.12.

6 Currently, Avista Corporation, doing business as Avista Utilities, is the utility offering electric and/or natural gas service in eastern Washington, northern Idaho, Oregon and Montana. Avista Capital is a subsidiary of Avista Corporation. Avista Capital currently is the parent corporation of Avista Corporation's non-regulated subsidiary investments and operations.

7 Avista proposes to form a holding company called AVA Formation Corp. ("AVA").<sup>1</sup> AVA would be the parent corporation of the existing regulated utility, which would be

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<sup>1</sup> This name will be used in the interim for purposes of designating the holding company. When the new name is publicly announced, Avista will notify the Commission and interested parties.

called Avista Corporation (doing business as Avista Utilities). Avista Corporation. would become a separate company under the parent company, AVA.

8 AVA would also be the parent company of Avista Capital, Inc., which would continue to hold the non-regulated subsidiary investments and operations, such as Avista Energy, Advantage IQ (formerly Avista Advantage) and Avista Power.

### III. NATURE OF THE STIPULATION

#### A. The Stipulation is subject to Commission approval

9 This Stipulation is subject to Commission approval. The Parties understand and agree that this Stipulation in no manner binds the Commission in ruling on the Application until such a time as the Commission approves the Stipulation.

#### B. Commitments

10 Appendix A of this Stipulation contains the complete list of the commitments and conditions (hereinafter referred to as "Commitments") Avista agrees to make and abide by to ensure that the formation and future conduct of the holding company corporate structure meets the Commission's "no harm to ratepayers" policy.<sup>2</sup> By virtue of executing this Stipulation, Avista agrees to perform all of the Commitments set forth in Appendix A according to the provisions of each Commitment as set forth therein.

11 Certain of the Commitments are made by the new, to-be-formed parent corporation, AVA. Avista agrees it has authority to make these commitments on behalf of AVA, and that upon its formation, AVA will be bound to abide by these commitments.

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<sup>2</sup> *In re PacifiCorp and Scottish Power PLC*, Docket UE-981627, 3<sup>rd</sup> Supplemental Order on Prehearing Conference (April 2, 1999) at 2-3.

#### IV. THE PROCESS FOR APPROVING THE STIPULATION

##### A. The Parties recommend approval and agree to support the Stipulation

12 The Parties recommend the Commission approve this Stipulation in its entirety, pursuant to WAC 480-07-740 and -750. The Parties agree to support this Stipulation before the Commission. Each Party agrees it will not appeal any portion of this Stipulation or Order approving the same, so long as no material changes are made to the Stipulation.

##### B. Hearing procedures

13 The Parties agree that within one business day of the date of execution of this Stipulation, Staff will file this Stipulation with the Commission on behalf of the Parties. The transmittal letter will ask the Commission to suspend the existing procedural schedule and schedule hearing dates to review the Stipulation.

14 The Parties understand the Commission has discretion, consistent with applicable law, to determine the appropriate procedures for determining whether it will approve this Stipulation.

##### C. Evidence

15 The Parties agree that the Commission should admit into evidence the direct case filed by Avista in this docket.<sup>3</sup> Additional evidence will be presented at a hearing on the settlement to be scheduled by the Commission, or as otherwise directed by the Commission.

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<sup>3</sup> This evidence consists of the direct testimony and exhibits of Mr. Norwood (Exhibit \_\_\_ (KON-1T) and Exhibits \_\_\_ (KNO-2) and \_\_\_ (KON-3) and Mr. Malquist (Exhibit \_\_\_ (MKM-1T) and Exhibits \_\_\_ (MKM-2) and \_\_\_ (MKM-3), and the direct testimony of Mr. Andrews (Exhibit \_\_\_ (EMA-1T).

**D. Effect of Commission approval without material changes**

16 The Parties agree that if the Commission approves the Stipulation without material change, this docket will be concluded, subject to any proceedings described in Part IV.F (¶¶ 19-24) below (“Most favored nations’ provision”).

**E. Effect of rejection or partial Commission approval of this Stipulation**

17 In the event the Commission rejects any part or all of this Stipulation, or imposes any additional material terms as a condition of approval of this Stipulation, each Party has the right to withdraw from this Stipulation. In order to withdraw, a Party must file a written notice of withdrawal with the Commission and send a copy to the other Parties, within 14 calendar days of the date of such action by the Commission.

18 If a Party withdraws pursuant to the foregoing procedures, this Stipulation is not effective, and no Party shall be bound or prejudiced by its terms. In that event, each Party is entitled to seek reconsideration of the Commission’s order partially approving the Stipulation, file testimony as it chooses, cross-examine witnesses, and do all other things necessary to put on such case as it deems appropriate. The Parties immediately will request the Commission to promptly convene a prehearing conference to establish a procedural schedule for the completion of the case. The Parties agree to cooperate in development of a schedule that concludes the proceeding on the earliest possible date, taking into account the needs of the Parties to prepare for hearings, to participate in hearings and to prepare briefs. However, after a Party withdraws, nothing in this Stipulation prevents two or more of the Parties from filing a settlement of the types described in WAC 480-07-730.



**F. “Most favored nations” provision**

19 In the process of approving the Reorganization, other jurisdictions<sup>4</sup> may include terms<sup>5</sup> that are not contained in this Stipulation. Accordingly, this Stipulation may be expanded or modified as a result of regulatory decisions or settlements in those other jurisdictions.

20 Avista agrees that the Commission shall have an opportunity and the authority to consider and adopt in Washington any terms to which Avista agrees or with which Avista is required to comply in any other jurisdiction, even if such terms are established after the Commission enters its order approving the Stipulation in this docket.

21 To facilitate the Commission’s consideration and adoption of such terms from other jurisdictions, the Parties urge the Commission to issue an order accepting this Stipulation as soon as practicable, but to expressly reserve in such order the right to re-open this Stipulation to add (without modification of the language thereof except such non-substantive changes as are necessary to make the term applicable to Washington) terms accepted or ordered in another jurisdiction.

22 The Parties recommend the following process related to potential additional terms originating from regulatory proceedings in other jurisdictions:

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<sup>4</sup>The Oregon and Montana commissions have yet to act on Avista’s Reorganization applications. On June 30, 2006, the Idaho Public Utilities Commission issued an order approving Avista’s reorganization application, based on a settlement in that state. *In re Application of Avista Corporation, dba Avista Utilities for an Order Approving a Corporate Reorganization to Create a Holding Company, AVA Formation Corp.*, Case AVU-E-06-1 and AVU-G-06-1 (Order 30091). The Federal Energy Regulatory Commission has also issued its “Order Authorizing Disposition of Jurisdictional Facilities” on April 18, 2006. *115 FERC ¶ 62,080*.

<sup>5</sup>“Terms” is broadly used to refer to provisions, conditions, commitments, covenants, elements *etc.*

- Within five calendar days after a stipulation with new or amended terms is filed by Avista with an agency in another jurisdiction, Avista will send a copy of the stipulation and terms to the Commission and the Parties.
- Within five calendar days after an agency in another jurisdiction issues an order that accepts a stipulation to which Avista is a party or issues an order that otherwise imposes new or modified terms, the applicable order, together with all commitments and conditions of any type agreed to by Avista or ordered by the agency in such other jurisdiction, will be filed with the Commission and served on the Parties by the most expeditious means practical. Within fifteen calendar days after receiving the last such filing from the other jurisdiction (“Final Filing”), any Party wishing to do so shall file with the Commission its response filing, including its position as to whether any terms from the other jurisdiction (without modification of the language thereof except such non-substantive changes as are necessary to make the term applicable to Washington) should be adopted in Washington, or whether such term would have an adverse impact on the Washington jurisdictional activities of Avista.
- Within five calendar days after any such response filing is filed, any Party to the docket may file a reply with the Commission. The Parties agree to support in their filings the issuance by the Commission of an order regarding the adoption of such terms as soon as practical thereafter, recognizing that the Reorganization cannot close until final orders from all relevant jurisdictions

have been issued. If the Commission adopts any such term, and the term is material, each Party has the right to withdraw from the Stipulation according to the procedures in Part IV.E (¶¶ 17-18) above.

23 Not later than the Final Filing, Avista will disclose to the Parties any written terms made in another state jurisdiction (between the date of the filing of the Stipulation and the receipt of the last order from an agency in a Reorganization docket) that were intended to encourage approval of the Reorganization or avoid an objection thereto.

24 The Parties believe other jurisdictions will complete their review of the Reorganization in time sufficient for this process to be complete by July 31, 2007. The parties therefore encourage the Commission to use its best efforts to complete the foregoing process by that date.

**V. EFFECTIVE DATE, APPROVAL DEADLINE, EXECUTION AND OTHER MATTERS**

**A. Effective date**

25 The effective date of this Stipulation shall be the date of the completion of the Reorganization, provided the Commission has approved this Stipulation by that date. The anticipated date of completion of the Reorganization is on or before July 31, 2007.

**B. Approval deadline**

26 The Commission should approve the Stipulation as soon as practical, subject only to the procedure under the “most favored nations” procedures discussed in Part IV.F (¶¶ 19-24) above. As noted there, the Parties believe other jurisdictions will complete their review of the Reorganization in time sufficient for the “most favored nations” process to be complete

by July 31, 2007. The parties therefore encourage the Commission to use its best efforts to complete the approval process by that date.

**C. Execution of the Stipulation**

27 This Stipulation is considered executed when all Parties sign the Stipulation. A designated and authorized representative may sign the Stipulation on a Party's behalf. The Parties may execute this Stipulation in counterparts. If the Stipulation is executed in counterparts, all counterparts shall constitute one agreement. A faxed signature page containing the signature of a Party is acceptable as an original signature page signed by that Party. Each Party shall indicate the date of its signature on the Stipulation.

**D. Integrated Agreement**

28 The Parties have agreed to this Stipulation as an integrated document. This Stipulation is the Parties' entire agreement on all matters set forth herein, and it supersedes any and all prior oral and written understandings or agreements in this docket.

**E. The Stipulation will not be construed against any Party as the drafter**

29 The Parties acknowledge that this Stipulation is the product of negotiations and compromise and shall not be construed against any Party on the basis that it was the drafter of any or all portions of this Stipulation.

**F. No precedent**

30 Nothing in this Stipulation (or any supporting testimony, presentation or briefing) shall be cited or construed as precedent or as indicative of a Party's position on a resolved issue, or asserted or deemed to mean that a Party agreed with or adopted another Party's

legal or factual assertions in this proceeding. The limitation in this paragraph shall not apply to any proceeding to enforce the terms of this Stipulation.

31 No Party shall be bound, benefited or prejudiced by any position asserted in the negotiation of this Stipulation, except to the extent expressly stated herein, nor shall this Stipulation be construed as a waiver of the rights of any Party unless such rights are expressly waived herein. Execution of this Stipulation shall not be deemed to constitute an acknowledgment by any Party of the validity or invalidity of any particular method, theory or principle of regulation or cost recovery.

32 No Party shall be deemed to have agreed that any method, theory or principle of regulation or cost recovery employed in arriving at this Stipulation is appropriate for resolving any issues in any other proceeding in the future.

**G. Inadmissibility of negotiations**

33 The Parties agree this Stipulation represents a compromise of the positions of the Parties in this case. Except to the extent necessary for a Party to explain before the Commission its own statements and positions with respect to the Stipulation, each Party agrees it will not offer into evidence any negotiations relating to this Stipulation in this or any other proceeding regarding this subject matter. Each Party agrees that such evidence is not admissible and each Party agrees to oppose the admission of such evidence. This paragraph does not apply to non-privileged, publicly available documents.

**H. Deadlines**

34 This Stipulation contains certain filing deadlines. If any such deadline falls on a weekend or a holiday, the filing is due the next business day.

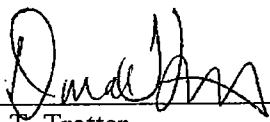
**I. Publicity**

35

Each Party agrees to provide all other Parties the right to review in advance of publication any and all announcements or news releases that any other Party intends to make about the Stipulation (with the right of review to include a reasonable opportunity to request changes to the text of such announcements). Each Party also agrees to include in any news release or announcement a statement to the effect that the Commission Staff's recommendation to approve the Stipulation is not binding on the Commission itself.

Respectfully submitted this 5<sup>th</sup> day of January, 2007.

**COMMISSION STAFF**

By   
Donald T. Trotter  
Senior Counsel, Office of the Attorney General  
Counsel for Washington Utilities and Transportation Commission Staff  
Date: 1/05/07

**AVISTA CORPORATION**

By \_\_\_\_\_  
David J. Meyer  
Attorney  
Vice President and Chief Counsel of Regulatory and Governmental Affairs for Avista Corp.  
Date:

**PUBLIC COUNSEL SECTION**

By Judith Krebs by Donald [Signature] per telephone authorization  
Judith Krebs 1/05/07  
Assistant Attorney General, Office of the Attorney General  
Public Counsel Section  
Date: 1/05/07

## APPENDIX A

### COMMITMENTS AND CONDITIONS

#### AVISTA CORPORATE REORGANIZATION TO FORM A HOLDING COMPANY (Docket UE-060273)

- 1.) Avista Corporation, doing business as Avista Utilities (hereinafter "Avista Utilities") will maintain its own books and records, separate from the books and records of AVA Formation Corp. (hereinafter "AVA"). The assets of Avista Utilities and AVA and their subsidiaries or affiliates will be separately accounted for. Avista Utilities' financial books and records and state and federal utility regulatory filings and documents will continue to be available to the Commission, upon request.
- 2.) AVA and Avista Utilities will provide the Commission and other parties to this Docket upon request, access to all books of account as well as all documents, data, and records of their affiliated interests, which pertain to transactions between Avista Utilities and its affiliated interests or which are otherwise relevant to the business of Avista Utilities.
- 3.) AVA, Avista Utilities and all affiliates will make their employees, officers, directors and agents available to testify before the Commission to provide information relevant to matters within the jurisdiction of the Commission.
- 4.) AVA and Avista Utilities agree that one of its independent directors on each Board of Directors will have had prior experience with respect to the operation, financial analysis or regulation of the regulated gas or electric utility industry.
- 5.) The Commission or its agents may audit the accounting records of AVA and its subsidiaries that are the bases for charges to Avista Utilities, to determine the reasonableness of allocation factors used by AVA to assign costs to Avista Utilities and amounts subject to allocation or direct charges. AVA agrees to cooperate fully with such Commission audits.
- 6.) Avista Utilities will file on an annual basis a copy of any affiliated interest report filed in other jurisdictions.
- 7.) AVA and Avista Utilities will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filing of applications and reports.



- 8.) Avista Utilities and AVA will not cross-subsidize between the regulated and non-regulated businesses or between any regulated businesses, and shall comply with the Commission's applicable orders and rules with respect to such matters.
- 9.) Nothing in these Conditions prevents Avista Utilities from having its own subsidiaries. However, no AVA holding (*i.e.*, a subsidiary held directly by AVA or a subsidiary held indirectly by AVA, such as a subsidiary of an AVA subsidiary) shall be conveyed to Avista Utilities or a subsidiary of Avista Utilities, without prior Commission approval.
- 10.) Any proposed cost allocation methodology for the allocation of corporate and affiliate investments, expenses, and overheads, required by law or rule to be submitted to the Commission for approval, will comply with the following principles:
  - a. For services rendered to Avista Utilities or each cost category subject to allocation to Avista Utilities by AVA or any of its affiliates, AVA must be able to demonstrate that such service or cost category is necessary to Avista Utilities for the performance of its regulated operations, is not duplicative of services already being performed within Avista Utilities, and is reasonable and prudent.
  - b. Cost allocations to Avista Utilities and its subsidiaries will be based on generally accepted accounting standards; that is, in general, direct costs will be charged to specific subsidiaries whenever possible and shared or indirect costs will be allocated based upon the primary cost-driving factors.
  - c. AVA and its subsidiaries will have in place accounting systems adequate to support the allocation and assignment of costs of executives and other relevant personnel to Avista Utilities.
  - d. An audit trail will be maintained such that all costs subject to allocation can be specifically identified, particularly with respect to their origin. In addition, the audit trail must be adequately supported. Failure to adequately support any allocated cost may result in denial of its recovery in rates.
  - e. Costs which would have been denied recovery in rates had they been incurred by Avista Utilities regulated operations will likewise be denied recovery whether they are allocated directly or indirectly through subsidiaries in the AVA group.
  - f. Any corporate cost allocation methodology used for rate setting, and subsequent changes thereto, will be submitted to the Commission for

approval if required by law or rule. An Intercompany Administrative Services Agreement (IASA) will be developed that will include the corporate and affiliate cost allocation methodologies. The IASA will be filed with the Commission as soon as practicable after the closing of the transaction. Approval of the IASA will be requested if required by law or rule, but approval for ratemaking purposes will not be requested in such filing. Amendments to the IASA will also be filed with the Commission.

- g. AVA and Avista Utilities commit to use asymmetrical pricing (i.e., lower of cost or market for transactions to Avista Utilities and higher of cost or market for transactions from Avista Utilities) for affiliate charges or costs, if a readily identifiable market for the goods, services or assets exists, and if the transaction involves a cost of more than \$100,000.
- 11.) Before December 31, 2009, neither Avista Utilities nor any of its subsidiaries will enter into any electric or natural gas commodity transactions, either physical or financial, with AVA or its other affiliates or subsidiaries, including Avista Energy and Avista Power. This Condition does not affect any other existing or future limitations on Avista Utilities' energy transactions or trades imposed by the Commission or otherwise.
  - 12.) Avista Utilities and AVA agree, as a condition of the transaction, to adhere to FERC's Standards of Conduct (18 C.F.R. Part 358, as promulgated by Order No. 2004, with modifications made by Order No(s) 2004-A and 2004-B) governing relationships of, and the sharing of information between, Avista Utilities' transmission function with any energy and marketing affiliates, and to adhere, as well, to any Code of Conduct governing relationships between the wholesale merchant function of Avista Utilities and any affiliated power marketer (as set forth in Avista's market-based rate schedule on file with FERC). Avista Utilities and AVA also agree, as a condition of the transaction, to adhere to FERC's rules governing "shared employees" with respect to the merchant and transmission function, including maintaining a list that identifies such shared employees. By agreeing to abide by these federal regulations as a condition of the transaction, Avista Utilities and AVA agree that they will not seek an exemption from such rules pursuant to 18 C.F.R. § 358.1(d), without prior Commission approval. The website at [www.oatiaoasis.com/avat/index.html](http://www.oatiaoasis.com/avat/index.html) ("FERC Standards of Conduct," then "Organizational Charts") provides access to Avista Utilities' departmental organizational charts and identifies shared employees within those departments.
  - 13.) Avista Utilities will maintain separate debt and, if outstanding, preferred stock ratings. Avista Utilities will maintain its own corporate credit rating, as well as ratings for each long-term debt and preferred stock (if any) issuance.

- 14.) Avista Utilities and AVA will not advocate for a higher cost of capital as compared to what Avista Utilities' cost of capital would have been, absent the reorganization.
- 15.) Within three months of closing of the transaction, AVA and Avista Utilities commit to obtain from one or more rating agencies written confirmation that Avista Utilities will have its own corporate credit rating, separate and apart from AVA, as well as separate ratings for each long-term debt and preferred stock (if any) issuance, and that it will not otherwise be consolidated with AVA for ratings purposes. If the ring-fencing provisions of this stipulation are insufficient for purposes of obtaining a separate rating for Avista Utilities, AVA and Avista Utilities will so notify the Commission and propose and implement, upon Commission approval, such additional ring-fencing provisions that are sufficient to secure separate corporate ratings for AVA and Avista Utilities.
- 16.) AVA and Avista Utilities will exclude all costs of the formation of the Holding Company from Avista Utilities' utility accounts.
- 17.) AVA and Avista Utilities will provide the Commission and other parties to this Docket upon request, with unrestricted access to all written information provided by and to credit rating agencies that pertains to Avista Utilities or AVA. AVA will also provide the Commission, and other parties to this Docket upon request, with unrestricted access to all written information provided by and to credit rating agencies that pertains to AVA's subsidiaries to the extent such information may potentially impact Avista Utilities.
- 18.) The capital requirements of Avista Utilities, as determined to be necessary to meet its obligation to serve the public, will be given a high priority by the Board of Directors of AVA and Avista Utilities.
- 19.) Avista Utilities agrees to request the Commission order described in RCW 80.08.040(4) for transactions subject to RCW 80.08 that Avista Utilities enters into following the effective date of the Reorganization.
- 20.) Nothing in these restructuring commitments shall be interpreted as a waiver of Avista Utilities' or AVA's rights to request confidential treatment for information that is the subject of any commitments.
- 21.) Recognizing the importance of increasing the equity component of its capital structure, Avista Utilities agrees that it will increase the actual utility equity component to 40% by June 30, 2008. Should it fail to do so, Avista Utilities agrees that in the next general rate case filed by it after June 30, 2008, it will use the most current actual utility equity ratio (derived from the most recent calendar quarter), in lieu of a hypothetical capital structure. To the extent that Avista Utilities incurs increased power supply or purchased gas costs that are

not recovered in retail rates in a timely manner, it would impair Avista Utilities' ability to build equity. Accordingly, the calculations to determine whether the target is met will be adjusted for any additional deferred power supply or purchased gas costs recorded on its books after January 1, 2007, which have been approved for recovery, but over a period longer than proposed by the Company. The calculations to determine whether the target has been met will also be adjusted for any changes to Generally Accepted Accounting Principles (GAAP) effective subsequent to December 15, 2006.

- 22.) AVA and Avista Utilities commit that Avista Utilities will not make any dividends to AVA if Avista Utilities' common equity ratio is below 30% of its Total Adjusted Capital, without Commission approval. AVA and Avista Utilities also agree that Avista Utilities will not make any dividends to AVA that will reduce Avista Utilities' common equity capital below 30% of its Total Adjusted Capital, without Commission approval. At such time as the actual utility equity component reaches 40% (see Condition 21, above), Avista Utilities will notify the Commission should any dividends to AVA reduce Avista Utilities' common equity below 35% of its Total Adjusted Capital. The notice will explain the principal causes of the situation. These percentages will be adjusted, as necessary, to account for any changes to Generally Accepted Accounting Principles (GAAP) effective after December 15, 2006, as well as for the treatment of deferred power supply or purchased gas costs, as referenced in Condition 21, above. For purposes of calculating the numerator of the percentage, common equity will not include any portion of Avista Utilities preferred stock issued and outstanding. Avista Utilities' Total Adjusted Capital is defined as common equity, preferred equity, long-term debt, short-term debt and capitalized lease obligations.
- 23.) Through December 31, 2016, Avista Utilities will provide notice to the Commission, and to other parties to this Docket upon request, when it increases the amount of any dividend payment by 10% or more over the previously-paid dividend.
- 24.) In the event of a credit rating downgrade of Avista Utilities, Avista Utilities will give notice to the parties in this Docket and schedule a meeting with Staff within one month of the downgrade to discuss the reason for the downgrade and Avista Utilities' plans going forward.
- 25.) On or before April 1, 2008, and on or before every anniversary date thereafter, Avista Utilities will file with the Commission, and will provide to other parties to this Docket upon request, an annual report for the preceding calendar year, in which it describes its compliance with Conditions 21, 22 and 23, concerning the equity component of the capital structure and payment of dividends.

- 26.) Avista Utilities is required to apply to the Commission for approval of security issuances pursuant to RCW Chapter 80.08. Avista Utilities will not seek an exemption from this requirement for twelve months following the closing of this transaction. Staff will evaluate the "all-in-cost" of issuances for inclusion in rates and the cost of any debt issuance recognized for ratemaking will not be higher than it otherwise would have been without the corporate reorganization.
- 27.) AVA and Avista Utilities will provide the Commission and other parties to this Docket upon request, access to corporate minutes including Board of Director's minutes and all committee minutes, along with any related source documents that are relevant to the business and risk analysis of Avista Utilities. Avista Utilities and the party requesting access will establish an agreeable procedure to review these confidential documents in Spokane, Washington.
- 28.) AVA and Avista Utilities will provide the Commission, and other parties to this Docket upon request, access to operational, internal and risk audit reports and documentation. Avista Utilities and the party requesting access will establish an agreeable procedure to review these confidential documents upon request.
- 29.) AVA and Avista Utilities will notify the Commission, and other parties to this Docket upon request, of all publicly announced proposals for divestiture, spin-off, or sale of any integral Avista Utilities function. AVA and Avista Utilities will also file for Commission approval of divestiture, spin-off, or sale of any integral Avista Utilities function, which is subject to WUTC jurisdiction. This condition does not limit any jurisdiction the Commission may have.
- 30.) Avista Utilities or AVA will notify the Commission, and other parties to this Docket upon request, prior to implementation of plans by Avista Utilities or AVA: (1) to form an affiliate for the purpose of transacting business with Avista Utilities' regulated operations; (2) to commence new business transactions between an existing affiliate and Avista Utilities; or (3) to dissolve an affiliate which has transacted substantial business with Avista Utilities.
- 31.) Avista Utilities or AVA will notify the Commission, and other parties to this Docket upon request, subsequent to AVA's or Avista Utilities' board approval and as soon as practicable following any public announcement of: (1) any acquisition of a regulated or unregulated business representing 5 percent or more of the capitalization of AVA; or (2) the change in effective control or acquisition of any material part or all of Avista Utilities by any other firm, whether by merger, combination, transfer of stock or assets.

- 32.) Upon request, Avista Utilities will provide to the Commission, and other parties to this Docket on an informational basis, credit rating agency news releases and final reports regarding Avista Utilities when such reports are known to Avista Utilities and are available to the public.
- 33.) AVA and Avista Utilities commit that in the event that Avista Utilities obtains a loan from its parent company or any affiliated company, Avista Utilities will, in any subsequent rate proceeding demonstrate that the debt obligation interest, terms, and conditions are comparable to or less than what Avista Utilities could have obtained in the market at the time the debt was obtained by Avista Utilities, that the loan is on reasonable terms and without markup to the holding company's cost of funds, and that the debt procurement will not interfere with any ring-fencing mechanisms that secure the utility.
- 34.) AVA and Avista Utilities will enter into an agreement that incorporates the ring-fencing provisions set forth herein, which agreement shall be binding upon AVA and Avista Utilities, and their respective Boards of Directors. This agreement will be filed with the Commission within three months of closing of the transaction. AVA and Avista Utilities commit that no amendments, revisions or modifications will be made to this agreement or any ring-fencing provisions without prior Commission approval for the sole purpose of addressing the ring-fencing provisions.
- 35.) Within three months of closing of the transaction, AVA commits to obtain a non-consolidation opinion that demonstrates that the ring-fencing around Avista Utilities is sufficient to prevent Avista Utilities from being pulled into an AVA bankruptcy. AVA commits to promptly file such opinion with the Commission. If the ring-fencing provisions of this agreement are insufficient to obtain a non-consolidation opinion, AVA agrees to promptly undertake the following actions:
- a) Notify the Commission of this inability to obtain a non-consolidation opinion.
  - b) Propose and implement, upon Commission approval, such ring-fencing provisions that are sufficient to prevent Avista Utilities from being pulled into an AVA bankruptcy.
  - c) Obtain a non-consolidation opinion.
- 36.) Unless another process is provided by statute, Commission regulations or approved Avista Utilities' tariff, AVA and Avista Utilities encourage the Commission to use the following process for administering the commitments. The Commission should give AVA and Avista Utilities written notification of any violation by either company of the commitments made in this application. If such failure is corrected within ten (10) business days for failure to file

reports, or five (5) business days for other violations, the Commission should take no action. The Commission shall have the authority to determine if the corrective action has satisfied or corrected the violation. AVA or Avista Utilities may request, for cause, an extension of these time periods. If AVA or Avista Utilities fails to correct such violations within the specified time frames, as modified by any Commission-approved extensions, the Commission may seek to assess penalties for violation of a Commission order, against either AVA or Avista Utilities, as allowed under state laws and regulations.

- 37.) The Applicants agree that the Commission shall have an opportunity and the authority to consider and adopt in Washington any commitments or conditions to which the Applicants agree or with which the Applicants are required to comply in other jurisdictions, even if such commitments and conditions are agreed to after the Commission enters its order in this docket. To facilitate the Commission's consideration and adoption of the commitments and conditions from other jurisdictions, the Parties urge the Commission to issue an order accepting this Stipulation as soon as practical, but to reserve in such order the explicit right to re-open to add commitments and conditions accepted or ordered in another state jurisdiction.
- 38.) AVA and Avista Utilities acknowledge and agree that the Commission retains its authority over Avista Utilities in the event of either voluntary or involuntary bankruptcy proceedings affecting either AVA or Avista Utilities, and that such authority is not preempted by applicable bankruptcy laws. Such Commission authorities are acknowledged to expressly include regulation of the issuance of securities (RCW 80.08), the mortgage or pledge of assets (RCW 80.12), and the disposition or sale of assets by Avista Utilities (RCW 80.12). Notwithstanding any bankruptcy, reorganization, or other insolvency proceedings with respect to AVA, AVA agrees it shall not acquiesce, petition or otherwise invoke or cause Avista Utilities to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against Avista Utilities under any federal or state bankruptcy, insolvency or similar law, or ordering the winding up of the affairs of or the liquidation of Avista Utilities (and will oppose, to the extent permitted by law, any such process), so long as Avista Utilities remains otherwise financially healthy.

**I. Publicity**

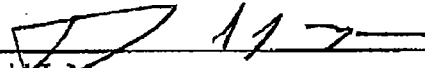
35 Each Party agrees to provide all other Parties the right to review in advance of publication any and all announcements or news releases that any other Party intends to make about the Stipulation (with the right of review to include a reasonable opportunity to request changes to the text of such announcements). Each Party also agrees to include in any news release or announcement a statement to the effect that the Commission Staff's recommendation to approve the Stipulation is not binding on the Commission itself.

Respectfully submitted this \_\_\_ day of January, 2007.

**COMMISSION STAFF**

By \_\_\_\_\_  
Donald T. Trotter  
Senior Counsel, Office of the Attorney General  
Counsel for Washington Utilities and Transportation Commission Staff  
Date:

**AVISTA CORPORATION**

By  \_\_\_\_\_  
David J. Meyer  
Attorney  
Vice President and Chief Counsel of Regulatory and Governmental Affairs for Avista Corp.  
Date: 1/05/07



BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of Avista Corporation d/b/a Avista Utilities for an Order Approving a Corporate Reorganization To Create a Holding Company, AVA Formation Corp.

DOCKET UE-060273

NARRATIVE IN SUPPORT OF SETTLEMENT STIPULATION

**I. PRELIMINARY MATTERS**

1           This Narrative Supporting Settlement Stipulation (“Narrative”) is filed pursuant to WAC 480-07-740(2) (a), on behalf of the parties signing the Settlement Stipulation (“Stipulation”) also filed today in this docket. This Narrative summarizes many aspects of the Stipulation. It is not intended to modify any terms of the Stipulation.

**A. Parties to the Stipulation**

2           The parties to the Stipulation are the signatories: Commission Staff (“Staff”), Avista Corporation, doing business as Avista Utilities (“Avista”), and the Public Counsel Section of the Attorney General’s Office (“Public Counsel”) (individually, “Party”; collectively, “the Parties”).

3           The other parties to this docket, Intervenors Northwest Industrial Gas Users (NWIGU) and the Industrial Customers of Northwest Utilities (ICNU), are not signatories. However, NWIGU’s counsel (Mr. Finklea) and ICNU’s counsel, Mr. Perkins, respectively advised Commission counsel (Mr. Trotter) that NWIGU and ICNU neither support nor oppose this Stipulation. Consequently, this is a multiparty settlement, as that term is defined in WAC 480-07-730(3). *Stip.* ¶ 3.

**B. Status of Approvals in Other Jurisdictions**

4 On June 30, 2006, the Idaho Public Utilities Commission issued an order approving Avista's reorganization application, based on a settlement in that state.<sup>1</sup> The Federal Energy Regulatory Commission has also issued its "Order Authorizing Disposition of Jurisdictional Facilities" on April 18, 2006.<sup>2</sup> The Oregon and Montana commissions have yet to act on Avista's Reorganization applications.

**C. Record for Commission Decision**

5 The Parties do not intend to file documentation supporting the Stipulation in addition to the Stipulation, this Narrative, and the proposed testimony and exhibits on file in this docket. *Stip.* ¶ 15. The Parties will be prepared to respond to questions from the Commission at any hearing on the Stipulation, and the Parties are willing to provide additional supporting documents should the Commission deem that necessary or appropriate. To that end, the parties propose to make available a panel of witnesses consisting of representatives of each signatory party, in order to respond to questions from the Commissioners at the time of hearing.

**D. Procedural Needs**

6 The Company wants the Reorganization to occur by July 31, 2007. That date is primarily due to the pendency of approval dockets in other jurisdictions. The Parties urge the Commission to schedule proceedings to consider the Stipulation as soon as practicable. The Stipulation contains a "most favored nations" provision that sets forth procedures for considering any additional terms ordered by other jurisdictions. *Stip.* ¶¶ 26 & 19-24.

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<sup>1</sup> *In re Application of Avista Corporation, dba Avista Utilities for an Order Approving a Corporate Reorganization to Create a Holding Company, AVA Formation Corp.*, Case AVU-E-06-1 and AVU-G-06-1 (Order 30091).

<sup>2</sup> 115 FERC ¶ 62,080.

## II. NATURE OF THE TRANSACTION

7           On February 16, 2006, Avista filed its "Application of Avista Corporation"  
("Application") with the Commission, seeking an order authorizing Avista to conduct a  
corporate reorganization, including the formation of a holding company to be known as  
AVA Formation Corp (hereinafter referred to as the "Reorganization").<sup>3</sup> This Commission  
has jurisdiction over such request pursuant to RCW 80.12.

8           Currently, Avista Corporation, doing business as Avista Utilities, is the utility  
offering electric and/or gas service in eastern Washington, northern Idaho, Oregon and  
Montana. Avista Capital is a subsidiary of Avista Corporation. Avista Capital currently is  
the parent corporation of Avista Corporation's non-regulated subsidiary investments and  
operations.

9           Avista proposes to form a holding company called AVA Formation Corp. ("AVA").  
AVA would be the parent corporation of the existing regulated utility, which would be  
called Avista Corporation (doing business as Avista Utilities). Avista Corporation would  
become a separate company under the parent company, AVA.

10          AVA would also be the parent company of Avista Capital, Inc., which would  
continue to hold the non-regulated subsidiary investments and operations, such as Avista  
Energy, Advantage IQ (formerly Avista Advantage) and Avista Power.

## III. OVERVIEW OF THE PROPOSED SETTLEMENT STIPULATION

11          The Stipulation is subject to Commission approval. *Stip.* ¶¶ 1 & 9. The Stipulation  
consists of two documents: the document entitled "Settlement Stipulation;" and Appendix A  
attached thereto. *Stip.* ¶ 4.

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<sup>3</sup> This name will be used in the interim for purposes of designating the holding company. When the new name  
is publicly announced, Avista will notify the Commission and interested parties.

**A. The Commitments are contained in Stipulation Appendix A**

12 Appendix A of the Stipulation contains a list of Commitments the Company agrees  
to meet as a condition of approval. That document speaks for itself. Offered here is a short  
summary of some of the key provisions.

13 Avista Utilities will keep separate books and records and will not cross-subsidize, or  
be cross-subsidized, by non-regulated businesses of its parent. *Stip. Appendix A,*  
*Commitments 1 & 8.* An agreed set of inter-company cost allocation principles is included.  
*Id., Commitment 10.*

14 Avista Utilities will maintain its own debt, preferred stock, and corporate credit  
ratings. *Id., Commitment 13.* The utility's equity will be funded by its parent, who agrees to  
hold as a high priority the utility's capital requirements. *Id., Commitment 18.*

15 Avista Utilities agrees to increase its equity ratio to 40% by June 30, 2008, and will  
not pay dividends to the extent doing so would reduce its equity ratio below 30%. *Id.,*  
*Commitments 21 & 22.* This is a more aggressive schedule than required by the settlement  
the Commission approved in Dockets UE-050482 and UG-050483.<sup>4</sup>

16 AVA will provide a "non-consolidation opinion" within three months of the closing  
of the transaction that demonstrates that Avista Utilities will be sufficiently separate so as  
not to be pulled into a holding company bankruptcy. *Id., Commitment 35.* AVA also agrees  
it will not support any attempt to cause Avista Utilities to be involved in a bankruptcy, so  
long as Avista Utilities is financially healthy. *Id., Commitment 38.*

17 Finally, there are several provisions under which AVA and Avista Utilities agree to  
provide information or other reports to the Commission of ongoing developments, which

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<sup>4</sup> The Commission approved an "equity building mechanism" that would result in at least a 38% equity ratio by December 31, 2008. *Settlement Agreement at ¶ 8, approved in Utilities & Transp. Comm'n v. Avista Corporation, Dockets UE-050482 and UG-050483, Order 05 (December 21, 2005).*

will help the Commission to better regulate the utility and protect consumers into the future. *E.g., Commitments 2, 5, 17, 27, 28 & 32 (access to books and information), Commitment 3 (access to personnel), Commitment 23 (notice of dividend increase of 10 percent or more), Commitment 24 (notice of credit rating downgrade), and Commitment 31 (notice of acquisitions).*

**B. The docket would be resolved and concluded**

18 If the Commission approves the Stipulation, this docket would be concluded, subject only to the possibility of invoking certain described procedures if material terms are added by other jurisdictions. *Stip. ¶¶ 16 & 19-25.*

**C. Effective date and approval procedures**

19 Because the Stipulation contains commitments Avista will implement only upon the completion of the reorganization, the Stipulation should only be effective when and if the reorganization occurs. That date is expected to be by July 31, 2007.

20 The approval process is addressed in ¶¶ 12-24 of the Stipulation. If the Commission approves the Stipulation in its entirety, the docket is complete, subject only to procedures under the “most favored nations” provisions. *Stip. ¶ 16.* If the Commission issues an order approving the Stipulation with a material change, the Stipulation is not effective if a party files a timely withdrawal from the Stipulation. The matter would then be set for hearing, although subsequent settlements are not precluded. *Stip. ¶¶ 17-18.*

21 The Stipulation is the entire agreement of the Parties, and the Parties recommend the Commission approve it in its entirety. *Stip. ¶¶ 1 & 12.* The Stipulation sets no precedent. *Stip. ¶¶ 30-32.*

#### IV. STATEMENT WHY THE PROPOSED SETTLEMENT IS IN THE PARTIES' INTEREST AND/OR THE PUBLIC INTEREST

22 WAC 480-07-740(2)(a) requires this Narrative to include a "statement of parties' views about why the proposal satisfies both their interests and the public interest." Each Party or, in some cases, a group of Parties, has contributed the following separate statements:

##### A. Statement by Avista

23 The holding company structure is a well-established form of organization for companies engaging in multiple lines of business, and is increasingly prevalent in the utility industry. Many utilities are organized under a public holding company structure and Avista is one of the few investor-owned utilities in the Pacific Northwest that is not currently organized under a holding company structure.<sup>5</sup>

24 Avista considers it to be in the best interest of the Company, its customers, and its shareholders, to change the corporate structure of Avista into a holding company structure. This Reorganization would provide additional protection for ratepayers by "ring-fencing" or further separating utility operations from the Company's other non-regulated businesses. Such separation would further insulate Avista Utilities and its customers from the risks associated with operating other businesses, while at the same time, permitting greater financing flexibility afforded by a holding company structure.

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<sup>5</sup> Other utilities in the Pacific Northwest have received approvals for holding company structure reorganizations in recent years. For example, the WUTC in 2000 approved, with conditions, Puget Sound Energy's proposed corporate reorganization to create a holding company structure. (See Docket UE-991779) In 1998, the Idaho Power Company received approval, with conditions, from the IPUC (Order 27348 in Case IPC-E-97-11), and the OPUC (Order No. 98-056 in Docket No. UM 877) of their application to form a holding company and the execution of a Share Exchange Agreement. (See also, Order 07, "Final Order Approving and Adopting Settlement Stipulation," *In re Joint Application of MEHC and PacifiCorp*, Docket UE-051090 (February 22, 2006)).

25

The proposed Reorganization would not entail the transfer of Utility assets, nor would it adversely affect the financial, technical, and managerial abilities of Avista Utilities. Avista customers would see no change in the Utility or its operations, because the Utility would continue to provide the same high-quality service as before the Reorganization. After the Reorganization, Avista Utilities would continue to be subject to the same regulatory jurisdiction of the Commission as to rates, services, accounting and other general matters of utility operations.

26

The benefits of a holding company structure may be generally summarized as follows: Avista's utility operations will be better separated from the non-utility businesses, making cross subsidization easier to avoid and further ensuring that non-utility business risk will not affect utility operations. Accordingly, the new structure will provide better legal protection for Avista Utilities from liabilities arising from other segments of Avista's businesses. Also, the new structure will permit investors, analysts, and rating agencies to more easily analyze and value the company's individual lines of business. Finally, capital structures and financing techniques may be used that are better suited to the particular requirements, characteristics and risks of the utility and non-utility businesses. Such structures and techniques should increase financial flexibility without adversely affecting the capital structure or creditworthiness of the utility and non-utility businesses. In conclusion, Avista's current corporate structure simply cannot accommodate the same degree of financial and legal separation as can a holding company structure.

**B. Statement by Commission Staff**

27

Avista Corporation is seeking Commission approval to form a holding company. Currently, the utility, Avista Utilities, is an operating division of Avista Corporation rather

than a separate legal entity. As a result of the proposed holding company structure, the utility will become a separate legal entity. The utility will be called Avista Corporation (doing business as Avista Utilities). The utility's parent corporation will be called AVA Formation Corp. (AVA), though that name is temporary.

28 Staff's goal was to assure the resolution of this docket is fair and just. The result is an agreement Staff supports as solidly in the public interest.<sup>6</sup>

29 Perhaps the most significant impact of this reorganization is that Avista Utilities will be a separate legal entity. It will issue its own securities, with its equity wholly-owned by AVA. Avista Utilities' common equity will be issued by AVA and transferred to Avista Utilities as needed to maintain a reasonable capital structure for the utility. Consequently, Avista Utilities' credit profile will be based on its own, stand-alone credit characteristics, rather than Avista as a whole. This is recognized in Stipulation Appendix A, Commitments 13 and 15.

30 This presents a potential benefit and a corresponding challenge. The primary long term benefit to Avista Utilities is that it will be separated from the impacts of the non-utility operations of Avista Corporation. For ratepayers to realize this benefit, however, the challenge is to get Avista Utilities on as firm a financial footing as possible, as soon as possible.

31 In this regard, the Stipulation calls for Avista Utilities to have a 40% equity ratio by June 30, 2008. *Stip. Appendix A, Commitment 21*. The Stipulation also has an "anti-raiding" provision that prevents Avista Utilities from issuing dividends to AVA if Avista

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<sup>6</sup> The commitments in this settlement are comparable to those made by MidAmerican Energy Holdings Company (MEHC) and PacifiCorp in the agreement approved by the Commission in 2006. See Order 07, "Final Order Approving and Adopting Settlement Stipulation," *In re Joint Application of MEHC and PacifiCorp*, Docket UE-051090 (February 22, 2006).



Utilities' equity ratio is below 30%, or if issuing the dividends would cause Avista Utilities' equity ratio to fall below 30%. *Stip. Appendix A, Commitment 22.*

32 For Staff, Commitments 21 and 22 are the central provisions of the Stipulation because they are concrete ratepayer protections designed to assure that ratepayers benefit from being a "stand alone" company from a corporate credit perspective.

33 Two other critical commitments are: 1) Avista Utilities and AVA's agreement to obtain a non-consolidation opinion that demonstrates that the "ring-fencing" around Avista Utilities "is sufficient to prevent Avista Utilities from being pulled into an AVA bankruptcy" (*Stip. Appendix A, Commitment 35*); and 2) AVA's agreement not to acquiesce, or seek to include Avista Utilities, in any AVA bankruptcy, so long as Avista Utilities is financially healthy. *Stip. Appendix A, Commitment 38.*

34 The non-consolidation opinion is a legal opinion from an outside law firm that the ring fencing is sufficient to prevent Avista Utilities from being drawn into the bankruptcy of another entity or entities in the "corporate tree." AVA also agrees it will not take steps to include Avista Utilities in such a bankruptcy.

35 Other important provisions include Avista's commitment to use "asymmetric pricing" for affiliate charges (*i.e.*, lower of cost or market for purchases *from* affiliates and higher of cost or market for sales *to* affiliates). *Stip. Appendix A, Commitment 10.* This favorable pricing formula is not required by existing statutes.

36 Finally, there are procedural elements such as a "most favored nations" provision, which assures that if any jurisdiction yet to approve this reorganization prescribes or approves additional conditions, this state can take advantage of that, subject to the procedures outlined in the Stipulation at ¶¶ 19-24.

37 In sum, Staff supports the settlement as in the public interest, and urges the  
Commission to approve the settlement without material change.

**C. Statement by Public Counsel**

38 Public Counsel believes that the Settlement Stipulation and the ring fencing  
provisions contained in Appendix A are appropriate and in the public interest. Public  
Counsel asks the Commission to adopt the Agreement for the reasons outlined below.

39 The Commission has jurisdiction over this proposed reorganization, including the  
authority to reject Avista Utilities' Application if it is not in the public interest. Public  
Counsel believes that Avista's Application without the conditions attached as Appendix A to  
the Settlement Stipulation is not in the public interest because it increases customer risks  
without offering any real countervailing benefits to counteract these risks.

40 Specifically, without sufficient ring fencing provisions to protect the regulated  
utility's financial exposure within the new corporate structure, the proposed reorganization  
potentially threatens the financial health of Avista Utilities. In particular, Public Counsel is  
concerned about a failure to vigilantly maintain separate books, records and assets to the  
detriment of Avista Utilities. If AVA were to go bankrupt, the failure to keep separate  
books, records and assets could financially expose Avista Utilities to AVA's bankruptcy.

41 The reorganization also creates the possibility of cross-subsidy between the regulated  
and non-regulated businesses of Avista Utilities and AVA. This includes an improper  
allocation of shared costs.

42 In addition, Avista's Petition potentially jeopardizes Avista Utilities' cost of capital  
since the regulated utility will be independent of credit ratings assigned to AVA. While this  
will likely be advantageous to Avista Utilities, the regulated utility enjoys significantly

higher capital needs than other members of the AVA corporate family and therefore, a higher cost of capital would have a greater effect on Avista Utilities.

43           Moreover, Avista continues to maintain a level of common equity well below the forty-percent (40%) allowed for rate-setting purposes in its last general rate case. The failure to ensure increased capitalization upon the reorganization leaves open the possibility that Avista Utilities will fail to meet the common equity level ordered by the Commission and embedded in rates.

44           Public Counsel is also concerned with energy trading transactions between AVA, Avista Utilities and their subsidiaries. The concern arises from the potential for inside information that may or may not be intentionally shared but results in less than optimal market transactions for the regulated utility. Such transactions have been difficult to trace and evaluate. Often the problem arises where there are shared employees between affiliated companies and where employees lack of clear policy guidance regarding restrictions on information sharing.

45           Public Counsel believes the conditions in the Settlement Stipulation will likely mitigate these problems and allow the petition to be in the public interest. For instance, the Agreement requires that Avista Utilities and AVA maintain separate books and be subject to audit by the Commission. AVA and Avista Utilities must also comply with all applicable Commission statutes and regulations regarding affiliated interest transactions. The two companies are prohibited from cross-subsidizing, and must strictly observe a proper allocation of shared costs. Any extension of credit or issuance of bonds between the two companies is prohibited unless approved subject to RCW 80.12. For applicable affiliate transactions, AVA and Avista Utilities agree to use "lower of cost or market" standard for

transactions to Avista Utilities and the “higher of cost or market” standard for transactions from Avista Utilities. Finally, Avista Utilities is restricted from paying dividends in situations where the payment of such dividends threatens Avista Utilities financial well-being.

46           With regard to the cost of capital, Avista agrees to hold ratepayers harmless for any increase in the cost of capital associated with the reorganization. Avista Utilities will maintain separate debt and its own corporate credit rating. Should this fail to occur, provisions are in place to establish potentially greater ring fencing provisions. In addition, Avista Utilities pledges to increase its common equity ratio to forty-percent (40%) by June 30, 2008 or the Company will be required to use its actual capital structure in the next general rate case subsequent to that date. Avista Utilities also agrees that if its common equity ratio falls below thirty-percent (30%) it cannot pay dividends without prior Commission approval. Once the Company reaches its goal of forty-percent (40%) equity, it must report to the Commission if its common equity ratio falls below thirty-five (35%) and explain why the Company’s equity has fallen.

47           To address the energy trading concern, as Avista Utilities transitions into a new holding company structure, neither Avista Utilities nor any of its subsidiaries will enter into any electric or natural gas commodity transactions, either physical or financial, with AVA or its other affiliates or subsidiaries, including Avista Energy and Avista Power before December 31, 2009. This condition will not affect any other existing or future limitations on Avista Utilities’ energy transactions or trades imposed by the Commission or otherwise. Additionally, Avista Utilities and AVA agree, as a condition of the transaction, to adhere to FERC’s Standards of Conduct governing the relationship between Avista Utilities’

transmission function with any of its energy and marketing affiliates, the wholesale merchant function of Avista Utilities and any affiliated power marketer. Avista Utilities and AVA also agree, as a condition of the transaction, to adhere to FERC's rules governing "shared employees" with respect to the merchant and transmission function, including maintaining a list that identifies such shared employee. The purpose of these provisions in the Settlement Stipulation is to ensure that the Commission will have jurisdiction to enforce these FERC requirements as a ring fencing protection warranted by the reorganization.

48 In conclusion, the Agreement satisfies Public Counsel's interests because it sets forth sufficient conditions that are likely to mitigate the potential negative consequences of the reorganization. First, Avista Utilities will be subject to ring fencing provisions that protect its customers' financial exposure, including protection from lower corporate credit ratings due to the reorganization. Second, AVA and Avista Utilities have agreed to limit cash transfers to AVA from Avista Utilities in those instances required to protect the financial health of the regulated utility. Third, AVA and Avista Utilities have agreed to affiliate transaction standards that exceed those required by Commission rules. Fourth, the Settlement provides that Avista Utilities will not seek recovery from ratepayers for the cost of the reorganization. Finally, the Settlement adopts by reference those protections established by the Federal Energy Regulatory Commission for the purpose of regulating electric or natural gas commodity transactions between affiliates or subsidiaries of Avista Utilities.

**V. SUMMARY OF LEGAL POINTS THAT BEAR ON THE PROPOSED SETTLEMENT**

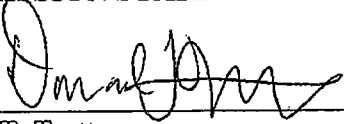
49 The Parties do not believe there is anything significant to discuss under this topic listed in WAC 480-07-740(2)(a).

**VI. CONCLUSIONS**

50 The Parties respectfully request the Commission approve the Settlement Stipulation filed in this docket. The Parties understand the Commission has certain discretion regarding the timing and procedures it will use to evaluate and reach a decision whether to approve the Stipulation.

DATED this 5<sup>th</sup> day of January, 2007.

**COMMISSION STAFF**

By   
Donald T. Trotter  
Senior Counsel, Office of the Attorney General  
Counsel for Washington Utilities and Transportation Commission Staff  
Date: 1/05/07

**AVISTA CORPORATION**

By \_\_\_\_\_  
David J. Meyer  
Attorney  
Vice President and Chief Counsel of Regulatory and Governmental Affairs for Avista Corp.  
Date:

**PUBLIC COUNSEL SECTION**

By Judith Krebs by Donald J. Trotter by telephone  
Judith Krebs authorization 1/05/07  
Assistant Attorney General, Office of the Attorney General  
Public Counsel Section  
Date: 1/05/07

**V. SUMMARY OF LEGAL POINTS THAT BEAR ON THE PROPOSED SETTLEMENT**

49 The Parties do not believe there is anything significant to discuss under this topic listed in WAC 480-07-740(2)(a).

**VI. CONCLUSIONS**

50 The Parties respectfully request the Commission approve the Settlement Stipulation filed in this docket. The Parties understand the Commission has certain discretion regarding the timing and procedures it will use to evaluate and reach a decision whether to approve the Stipulation.

DATED this \_\_\_ day of January, 2007.

**COMMISSION STAFF**

By \_\_\_\_\_  
Donald T. Trotter  
Senior Counsel, Office of the Attorney General  
Counsel for Washington Utilities and Transportation Commission Staff  
Date:

**AVISTA CORPORATION**

By David J. Meyer  
David J. Meyer  
Attorney  
Vice President and Chief Counsel of Regulatory and Governmental Affairs for Avista Corp.  
Date: 1/05/07

**PUBLIC COUNSEL SECTION**

By \_\_\_\_\_  
Judith Krebs  
Assistant Attorney General, Office of the Attorney General  
Public Counsel Section  
Date: