DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER REDFORD
COMMISSIONER SMITH
COMMISSION SECRETARY
LEGAL
WORKING FILE

FROM: TERRI CARLOCK

DATE: FEBRUARY 28, 2014

RE: IN THE MATTER OF AVISTA CORPORATION'S APPLICATION FOR AUTHORITY TO ISSUE UP TO 7,250,000 SHARES OF COMMON STOCK; CASE NO. AVU-U-13-01.

On December 4, 2013, Avista Corporation (Avista) applied for authority to offer, issue and sell up to 7,250,000 shares of authorized but unissued Common Stock, without par value, (Common Stock). This is not a typical security issuance since the primary purpose of the stock issuance is to fund the merger with Alaska Energy and Resources Company (AERC). Avista originally requested an order within sixty (60) days of the filing, but the Company agreed to extend the date to allow Staff to complete its examination of the proposal.

On November 4, 2013, Avista entered into an Agreement and Plan of Merger (Merger Agreement), with Alaska Merger Sub, lnc. (Merger Sub), and AERC. Merger Sub is a wholly-owned corporation of Avista and was created solely for the purpose of facilitating Avista's acquisition of AERC, which includes the utility operations of Alaska Electric Light and Power (AEL&P). Upon receipt of all necessary approvals, Merger Sub would merge with and into AERC and dissolve as a corporate entity, leaving AERC as a wholly-owned subsidiary of Avista. AEL&P is a vertically integrated electric utility providing electric service to the City and Borough of Juneau, Alaska, and is regulated by the Regulatory Commission of Alaska (RCA).

At the closing of the acquisition of AERC by Avista, the issued and outstanding shares of AERC common stock would be exchanged for shares of Avista common stock, per the terms of the Merger Agreement. The purchase price for AERC at closing is $170 million, less the assumption of then outstanding debt and other closing adjustments per the Merger Agreement. Using current projections, the value of Avista common stock to be issued in exchange for AERC common stock is estimated to be $145 million. The actual number of shares of Avista common stock to be issued is dependent on the closing stock price of Avista's shares. The current estimate of $145 million in net consideration will change at closing based upon the actual amount of debt outstanding and other adjustments per the Merger Agreement at that time. Avista is requesting authority to issue up to 7,250,000 shares of common stock. Avista's request for authorized shares up to 7,250,000 shares is limited to the acquisition of AERC. Any unused shares of the 7,250,000 related to the AERC acquisition would be terminated. Following the closing of the transaction, debt would be issued at AEL&P and AERC to rebalance the capital structure to achieve a capital structure for AERC that is comparable to the existing capital structure at Avista. Any debt assumed on the books of AERC and AEL&P and any new debt would be backed by the assets of AEL&P and AERC, and not the utility assets of Avista. The end result will be that Avista's utility customers will experience the same capital structure after the completion of the transaction, as they currently do prior to the transaction.

As part of the rebalancing of the capital structure at AEL&P and AERC, funds would be transferred from AERC to Avista, and used to fund the utility capital budget and utility operating costs at Avista. Therefore, in addition to funding the merger investment, a portion of the proceeds from the initial common equity issuance would ultimately be used to fund the utility capital budget and utility operating costs at Avista. That is, absent the issuance of Avista common stock related to the AERC transaction, Avista would have otherwise issued approximately $70 million of common equity to fund the utility operations of Avista.

AEL&P is a wholly-owned subsidiary of AERC and would continue to be a wholly-owned subsidiary of AERC following the completion of the proposed acquisition by Avista. AEL&P would continue to be operated by the same employees operating the utility today, including the existing management team of AEL&P. The customers, service territory, facilities and generating resources of AEL&P are geographically and electrically isolated, which limits Avista's opportunity to integrate AEL&P's operations with its existing utility operations in Washington, ldaho and Oregon. Avista intends to hold and manage AEL&P as a stand-alone utility.

To the extent Avista employees dedicate time and incur costs supporting the operation of AERC and AEL&P, those costs would be separately tracked and directly assigned to AERC and AEL&P. Likewise, if AEL&P employees were to provide support for Avista's utility operations, such costs would be directly assigned to Avista. The Company expects such assignment of costs, both to AEL&P and from AEL&P, to be relatively small since AEL&P will continue to operate as a standalone utility. In the future, if opportunities arise for the consolidation of certain Avista and AEL&P utility functions, it may be appropriate to propose some form of cost allocation between the two utilities.

Avista will use the same methodology for direct assignment of costs to the proposed AERC and AEL&P subsidiary operations, as it uses for Avista's existing subsidiary operations. When Avista's employees spend time providing services and support to existing subsidiaries, these employee costs are charged to suspense accounts (Deferred Debit Account No. 186), are loaded for benefits, and are then established as a receivable (FERC Account No. 146) when billed to the subsidiary. If other resources are expended during the course of this work, such as travel or consulting services, these costs are also charged to suspense accounts and billed to the subsidiary. All corporate services provided, and costs incurred, are direct billed to subsidiaries at cost. No additional margin or profit is included and no assets are allocated. This assignment of Avista employee costs are then billed back to the subsidiary at cost and serve to reduce the utility's expenses. Where these costs are included in Avista utility rates, Avista's existing utility customers would see a slight reduction of costs (benefit) as a result of this direct assignment of costs. It is Avista's ongoing responsibility to demonstrate that the acquisition of AERC and AEL&P does not result in harm to Avista Utilities' existing customers.

STAFF RECOMMENDATIONS

Staff recommends the following:

1) Approval of the requested common stock issuance authority.

2) Avista file all final merger closing documents.

3) Avista file all final closing journal entries.

4) Avista Utilities maintain its own utility operating books and records, separate from AERC books and records. Avista notify the Commission Staff prior to any consolidation of the operating books in the future. Staff recommends Avista maintain separate Subaccounts.

5) Avista provide access to all books and records including final merger tax elections. Avista also provide adequate audit trails for all affiliated operations related to any affiliated transactions.

6) Avista will not include in Avista utility operations for recovery from existing utility customers, any costs related to Alaska merger sub AEL&P, AERC or any purchase premium or goodwill without express approval from this Commission.

7) Consistent with prior Orders, Staff also recommends that Avista be required to file status reports with the Commission reflecting pertinent quarterly financial information to include the following: (a) Debt to Equity Ratio, (b) Enterprise Value, (c) Net Income Available to Common Stock, and (d) Common Shares Outstanding.

COMMISSION DECISION

Does the Commission accept Staff's recommendations to:

1. Approve Avista's request to issue up to 7,250,000 shares of Common Stock?
2. Approve Staff's recommended additional filing requirements and conditions?

Terri Carlock

Terri Carlock

i:udmemos/avuu13.1 dm