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Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)	
AVISTA CORPORATION DBA AVISTA)	CASE NO. AVU-E-06-1
UTILITIES FOR AN ORDER APPROVING A)	AVU-G-06-1
CORPORATE REORGANIZATION TO)	
CREATE A HOLDING COMPANY, AVA)	COMMENTS OF THE
FORMATION CORP.)	COMMISSION STAFF
)	
)	

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Cecelia A. Gassner, Deputy Attorney General, in response to the Notice of Application, Notice of Workshop and Notice of Modified Procedure in Order No. 30026 issued on April 28, 2006, submits the following comments.

BACKGROUND

On February 16, 2006, Avista Corporation dba Avista Utilities (“Avista” or “Company”) filed an Application with the Commission seeking an order for authority to conduct a corporate reorganization and form a holding company to be known as AVA Formation Corp. Avista believes that a holding company structure would allow the Company to better respond to the changing business environment of the electric and natural gas industry, while providing the opportunity to further insulate its utility business from its non-utility business. The Company believes that this reorganization would

provide additional protection for ratepayers by “ring-fencing” or further separating utility operations from the Company’s other non-regulated businesses. Additionally, the Company believes that a holding company structure would provide better financing flexibility to the organization allowing it to effectively compete in the industry.

This Commission has jurisdiction over this request pursuant to *Idaho Code* § 61-328. The holding company, AVA Formation Corp. (the “Parent Corporation” or “AVA”), would be formed as the parent company of the existing regulated company, Avista Corporation. The Parent Corporation would also be the parent company of Avista Capital, Inc., which would continue to hold non-regulated subsidiaries.¹ For the purposes of these comments, the entity that would be the regulated utility provider after the proposed reorganization, if approved, shall be known herein as “Avista Utilities.”

On April 28, 2006, the Commission issued its Order No. 30026, providing a Notice of Application, Notice of Workshop, and a Notice of Modified Procedure. No petitions to intervene in this proceeding were filed in this matter.

Pursuant to the Commission’s Order No. 30026, representatives of the Parties conducted a workshop on May 16, 2006, and engaged in informal settlement discussions with a view toward resolving the Application in this case. Based upon the settlement discussions among the Parties as a compromise of the positions in this case, and for other consideration as set forth below, the Parties agree to various Commitments.

STAFF ANALYSIS

Staff reviewed the requirements necessary for the Commission to approve the reorganization and, as Staff discovered potential issues, to evaluate whether those issues created by the reorganization would have an adverse effect on customers or would pose a risk to the organization’s overall credit rating. Staff applied the standards of review set forth in *Idaho Code* § 61-328 and *Idaho Code*, Title 61, Chapter 9. *Idaho Code* § 61-328 provides that “No electric public utility ... shall merge, sell, lease assign or transfer, directly or indirectly, in any manner whatsoever, any such property or interest therein ... except when authorized to do so by order of the public utilities commission.” More specifically, this statute requires that the Commission make three specific findings:

¹ Avista Corporation, doing business as Avista Utilities, is currently the corporate parent. The proposed structure would make Avista Utilities a separate company under the Parent Corporation and Avista Corporation would no longer exist as an operating entity.

- a. That the transaction is consistent with the public interest;
- b. That the cost of and rates for supplying service will not be increased by reason of such transaction; and
- c. That the applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain said property in the public service.

Title 61, Chapter 9 (Issuance of Securities by Public Utilities) of the Idaho Code specifies the requirements Avista must follow to obtain authority to reorganize. Staff concerns discussed during the review and informal discussions included: customer guarantees and service performance standards; access to the books and records of Avista Utilities, the Parent Corporation and affiliates; the composition of the Board of Directors of both entities; capital commitments; resource acquisition on a level playing field; low income customer programs; and, especially ring-fencing.

The final Stipulation and Commitments (Appendix A) agreed to by the parties in Idaho that address the collective concerns of those parties. Generally, in addition to compliance with Idaho law, the components of the Commitments can be broken down into three categories of compliance:

- 1) Adherence to ring-fencing provisions;
- 2) Providing Staff access to books and records; and
- 3) Regulatory reporting requirements.

It is Staff's belief that Commitment Nos. 1, 4, 8, 9, 10, 11, 15, 17, 18, 19, 29, 30, and 31 address the first category, with agreed upon ring-fencing provisions ranging from maintaining separate books and records for each entity to providing a non-consolidated opinion to the Commission demonstrating that the ring-fencing around Avista Utilities is sufficient to prevent Avista Utilities from being pulled into a Parent Corporation bankruptcy proceeding. As outlined in Commitment No. 31, by agreeing to this requirement, the Company would have to take immediate action, if results of a non-consolidated opinion revealed that the organization's ring-fencing protocols have been breached or circumvented, in order to remedy such breach or circumvention. This Commitment is necessary because it provides Staff and the Commission with additional notice of faults in internal controls and provides insight to measures taken to resolve those deficiencies. A non-consolidated opinion would be documented in the Company's books and records along with audit reports and a risk management analysis detailing causes and corrective measures the Company implemented in response to any deficiencies.

Additionally, Commitment Nos. 2, 3, 5, 13, 23, and 24 provide Staff access to a full range of books and records, credit reports, Board of Directors minutes, internal audit and risk reports and

confidential documents which would pertain to Avista Utilities and its affiliates including the Parent Corporation. Comprehensive reporting requirements have also been agreed upon which would require the Parent Corporation and Avista Utilities to report to Staff and request approval from the Commission when certain events occur. These events include diverse activities such as procuring loans, conducting spin offs, dissolution of business activities, dividend payment arrangements and changes in the credit ratings of each entity.

In addition, comprehensive arrangements have been agreed to for complying with cost allocation methodologies including rate-setting and cost-sharing. In Commitment No. 17, the "Equity Building Mechanism," Avista Utilities agrees that it would increase the actual utility equity component to 35% by December 31, 2007 and to 38% by December 31, 2008. To the extent Avista Utilities incurs increased power supply or purchased gas costs that are not recovered in retail rates in a timely manner, its ability to build equity would be impaired. Accordingly, the calculations to determine whether the targets are met will be adjusted for any additional deferred power supply or purchased gas costs recorded on Avista Utilities' books after January 1, 2006, which have been approved for recovery, over a period longer than that proposed by the Company. Failure to meet the first target will result in an automatic reduction in base utility rates (spread uniformly across all classes) of 2%, effective April 1, 2008. Failure to meet the second target would result in a reduction of 2%, effective April 1, 2009. If the Company fails to achieve the first target but meets the second one, the 2% reduction on April 1, 2008 would be reversed prospectively as of April 1, 2009. If it meets the first target but misses the second, the April 1, 2009 reduction would remain in effect until its next general rate case. If Avista Utilities misses both targets, the total reduction would equal 4%, which would remain in effect until the next general rate case.

Another area of discussion between Staff and the Company concerned dividend payments. The Company agreed, in Commitment No. 18, that Avista Utilities will not make any dividends to the Parent Corporation that would reduce Avista Utilities' common equity capital below 25% of its Total Adjusted Capital without the Commission's approval. This percentage will be adjusted, as necessary, to account for any changes to Generally Accepted Accounting Principles (GAAP) after approval of this transaction. For the purpose 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.

Staff, in reviewing the Company's Application and discussing the agreed-upon Commitments, took into account customer comments that expressed concerns regarding loan arrangements and inter-company financing. Commitment No. 29 addresses these concerns by requiring Avista Utilities to demonstrate that the procurement of any loan from the Parent Corporation does not interfere with any of the ring-fencing mechanisms that secure the utility.

Keeping in mind the standards of *Idaho Code* § 61-328, Staff discussed commitments with the Company to secure and demonstrate that those standards have been met. In particular, the reorganization plan is designed in a manner that fully protects the interests of its customers because the plan further insulates customers from the risks associated with what would be the Parent Corporation's unregulated operations. Three specific examples of customer protection and assurance that costs will not increase due to the transaction include: 1) Commitment No. 12, which states that the cost of formation of the Parent Corporation would not be included in future Avista Utilities ratemaking proposals; 2) Commitment No. 22, under which 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; and 3) Commitment No. 29, which states that "cross-subsidization" between Avista Utilities and other affiliates must be entirely transparent so that in any subsequent rate proceedings Avista Utilities would be required to demonstrate that any debt obligation interest, terms and conditions are comparable or less than what could have been obtained in the market.

The reorganization should reduce the utility's risk and improve credit ratings. Staff does not anticipate rating downgrades based on recent credit rating reviews. However, in the event of a credit rating downgrade due to the reorganization, Staff will calculate the impact on customers and propose an adjustment be made to Avista Utilities' revenue requirement in the appropriate rate proceedings.

The provisions set out in the Commitments (Appendix A) assure that the public interest is protected with ring-fencing provisions and that these barriers are not overcome by any affiliate where the credit rating of one is used to offset the diminished rating of the other. The operations and structure of Avista Utilities and the Parent Corporation would continue to meet the requirement of having the bona fide intent and financial ability to operate and maintain said property in the public service.

STAFF RECOMMENDATION

The Staff recommends approval of the proposed reorganization given that the Company and its affiliates have agreed to implement these specific commitments, conditions and reporting mechanisms. Staff recommends that the Commission accept and approve the Stipulation and adopt the Commitments in Appendix A. Staff believes that these Commitments adequately protect Idaho ratepayers and serve the public interest.

Respectfully submitted this 16th day of June 2006.



Cecelia A. Cassner
Deputy Attorney General

Technical Staff: Tom McKeown
Terri Carlock

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 16TH DAY OF JUNE 2006, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. AVU-E-06-1/AVU-G-06-1, BY E-MAILING A COPY THEREOF AND BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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