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UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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

This Stipulation (“Stipulation”) is entered into by and between Avista Corporation, doing business as Avista Utilities (“Avista”), and the Idaho Public Utilities Commission Staff (“Staff”) (collectively referred to as the “Parties”).

I. INTRODUCTION

1. The terms and conditions of this Stipulation are set forth herein. The Parties agree that this Stipulation represents a fair, just and reasonable compromise of the issues raised in this proceeding and that this Stipulation is in the public interest. The Parties, therefore, recommend that the Public Utilities Commission (“Commission”) approve the Stipulation and all of its terms and conditions. Reference IDAPA 31.01.01.272,274.

II. BACKGROUND

2. On February 16, 2006, Avista 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 (hereinafter referred to as the "Reorganization"). This Commission has the jurisdiction over such 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

3. 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.

4. No petitions to intervene in this proceeding were filed in this matter.

5. 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 the following terms:

¹Avista 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.

III. TERMS OF THE STIPULATION

6. Appendix A contains the complete list of commitments that Avista agrees to make related to the formation and future conduct of the holding company corporate structure (hereinafter referred to as "Commitments"). 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.

7. In the process of obtaining approvals of the Reorganization in other states, the Commitments may be expanded or modified as a result of regulatory decisions or settlements. Avista agrees that the Commission shall have an opportunity and the authority to consider and adopt in Idaho any commitments or conditions to which Avista agrees or with which Avista is 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 Appendix A to add (without modification of the language thereof except such non-substantive changes as are necessary to make the commitment or condition applicable to Idaho) commitments and conditions accepted or ordered in another state jurisdiction. The Parties recommend the following process related to potential additional commitments and conditions originating from proceedings in other states:

- Within five calendar days after a stipulation with new or amended commitments is filed by Avista with a commission in another state

jurisdiction, Applicants will send a copy of the stipulation and commitments to the Idaho Commission Staff.

- Within five calendar days after a commission in another state jurisdiction issues an order that accepts a stipulation to which Avista is a party or otherwise imposes new or modified commitments or conditions, that order, together with all commitments and conditions of any type agreed to by Avista or ordered by the commission in such other state, will be filed with the Commission and served on all Parties to this docket by the most expeditious means practical. Within fifteen business days after receiving the last such filing from the other states (“Final Filing”), any Party to the docket wishing to do so shall file with the Commission its response, including its position as to whether any of the covenants, commitments and conditions from the other jurisdictions (without modification of the language thereof except such non-substantive changes as are necessary to make the commitment or condition applicable to Idaho) should be adopted in Idaho.
- Within five calendar days after any such response filing, 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 commitments and conditions as soon as practical thereafter, recognizing that the Reorganization cannot close until final state orders have been issued.

8. Not later than the Final Filing, Avista will disclose to the Parties any written commitments, conditions or covenants made in another state jurisdiction (between the date of the filing of the Stipulation and the receipt of the last state order in the Reorganization docket) intended to encourage approval of the Reorganization or avoidance of an objection thereto.

9. The Staff, by signing this Stipulation, acknowledges that Avista has satisfied the standard under *Idaho Code* § 61-328 for approval of the Reorganization and requests that the Commission issue its order approving the Application and this Stipulation. The Parties encourage the Commission to enter a final Idaho approval order by July 31, 2006.

10. The Parties submit this Stipulation to the Commission and recommend approval in its entirety pursuant to IDAPA 31.01.01.274. Parties shall support this Stipulation before the Commission, and no Party shall appeal any portion of this Stipulation or Order approving the same. If this Stipulation is challenged by any person not a party to the Stipulation, the Parties to this Stipulation reserve the right to cross-examine witnesses and put on such case as they deem appropriate to respond fully to the issues presented, including the right to raise issues that are incorporated in the settlements embodied in this Stipulation. Notwithstanding this reservation of rights, the Parties to this Stipulation agree that they will continue to support the Commission's adoption of the terms of this Stipulation.

11. The Parties agree that this Stipulation represents a compromise of the positions of the Parties in this case. Other than the above-referenced positions and any testimony or comments filed in support of the approval of this Stipulation, and except to the extent necessary for a Party to explain before the Commission its own statements and positions with respect to the Stipulation, all

negotiations relating to this Stipulation shall not be admissible in evidence in this or any other proceeding regarding this subject matter.

12. Avista acknowledges that the Commission's approval of the Stipulation, the Commitments or the Application shall not bind the Commission in other proceedings with respect to the determination of prudence, just and reasonable character, rate or ratemaking treatment, or public interest of services, accounts, costs, investments, expenditures or actions referenced in these Commitments.

13. In the event the Commission rejects any part or all of this Stipulation, or imposes any additional material conditions on approval of this Stipulation, each Party reserves the right, upon written notice to the Commission and other Parties to this proceeding, within 14 days of the date of such action by the Commission, to withdraw from this Stipulation. In such case, no Party shall be bound or prejudiced by the terms of this Stipulation, and each Party shall be entitled to seek reconsideration of the Commission's order, file testimony as it chooses, cross-examine witnesses, and do all other things necessary to put on such case as it deems appropriate. In such case, the Parties immediately will request the prompt convening of a prehearing conference for purposes of establishing 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 in participating in hearings and preparing briefs.

14. 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. 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. No findings of fact or conclusions of law other than those stated herein shall be deemed to be implicit in this Stipulation.

15. Subject to Paragraph 16 of this Stipulation, the effective date of this Stipulation shall be the date of the completion of the Reorganization.

16. The obligations of Avista under this Stipulation are subject to the Commission's approval of the Application in this docket on terms and conditions acceptable to Avista, in its sole discretion, and the completion of the Reorganization.

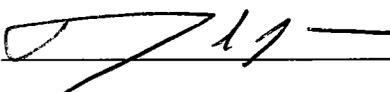
17. To the extent any of the above referenced filing dates fall on a weekend or a holiday, the filing shall be due on the next business day.

Respectfully submitted this 15th day of June, 2006.

Idaho Public Utilities Commission Staff

By 
Cecelia A. Gassner
Deputy Attorney General

Avista Corporation

By 
David J. Meyer
Vice President and Chief Counsel of Regulatory and Governmental Affairs

**AVISTA CORPORATE REORGANIZATION
TO FORM A HOLDING COMPANY
(CASE NO. AVU-E-06-1/AVU-G-06-1)**

- 1.) Avista Utilities will maintain its own books and records, separate from AVA's books and records. 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 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.) 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 not covered by the provisions of any cost sharing agreement, if a readily

identifiable market for the goods, services or assets exists, and if the transaction involves a cost of more than \$100,000.

- 10.) 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.
- 11.) 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.
- 12.) AVA and Avista Utilities will exclude all costs of the formation of the Holding Company from Avista Utilities' utility accounts.
- 13.) AVA and Avista Utilities will provide the Commission 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 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.
- 14.) 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.
- 15.) Neither Avista Utilities nor its subsidiaries will, on a prospective basis, without prior notification to the Commission, make loans or transfer funds (other than dividends and payments for inter-company services provided as part of the normal course of business or routine cash management functions or current money pool arrangements) to AVA or its affiliates, or assume any obligation or liability as guarantor, endorser, surety or otherwise for AVA or its affiliates; provided that this condition will not prevent Avista Utilities from assuming any obligation or liability on behalf of a subsidiary of Avista Utilities. Any changes to current money pool arrangements will require Commission approval. AVA will not pledge any of the assets of the business of Avista Utilities as backing for any securities which AVA or its affiliates (but excluding Avista Utilities and its subsidiaries) may issue.

- 16.) 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.
- 17.) Equity Building Mechanism: The Company agrees that it will increase the actual utility equity component to 35% by December 31, 2007 and to 38% by December 31, 2008. To the extent the Company incurs increased power supply or purchased gas costs that are not recovered in retail rates in a timely manner, it would impair the Company's ability to build equity. 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 the Company's books after January 1, 2006, which have been approved for recovery, but over a period longer than 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 the Company misses both targets, the total reduction would equal 4%, which would remain in effect until the next general rate case.

- 18.) AVA and Avista Utilities commit that Avista Utilities will not make any dividends to AVA that will reduce Avista Utilities' common equity capital below 25% of its Total Adjusted Capital without Commission 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 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.
- 19.) Through December 31, 2016, Avista Utilities will provide the Commission notice when it increases the amount of any dividend payment by 10% or more over the previously-paid dividend.
- 20.) In the event of a credit rating downgrade of Avista Utilities, the Company will schedule a meeting with Staff within one month of the downgrade to discuss the reason for the downgrade and the Company's plans going forward.
- 21.) On or before April 1, 2008, and on or before every anniversary date thereafter, Avista Utilities will provide to the Commission an annual report for the preceding calendar year, in which it describes its compliance with the

provision of items 17, 18 and 19, concerning the equity building mechanism and payment of dividends.

- 22.) Avista Utilities is required to apply to the Commission for approval of security issuances pursuant to Idaho Code Title 61, Chapter 9. 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.
- 23.) AVA and Avista Utilities will provide the Commission 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 Commission Staff will establish an agreeable procedure to review these confidential documents in Spokane, WA upon request.
- 24.) AVA and Avista Utilities will provide the Commission access to operational, internal and risk audit reports and documentation. Avista Utilities and the Commission Staff will establish an agreeable procedure to review these confidential documents upon request.
- 25.) AVA and Avista Utilities will provide the Commission and Staff with notification 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 IPUC jurisdiction. This condition does not limit any jurisdiction the Commission may have.
- 26.) Avista Utilities or AVA will notify the Commission 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.
- 27.) Avista Utilities or AVA will notify the Commission 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.

- 28.) Avista Utilities will provide to the Commission, upon request, 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.
- 29.) 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.
- 30.) 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.
- 31.) 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.
- 32.) 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.

- 33.) The applicants agree that the Commission shall have an opportunity and the authority to consider and adopt in Idaho 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.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 15TH DAY OF JUNE 2006, SERVED THE FOREGOING **MOTION FOR APPROVAL OF STIPULATION AND STIPULATION**, 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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SECRETARY