

DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: CECELIA A. GASSNER

DATE: JUNE 24, 2006

SUBJECT: AVISTA CORPORATION'S APPLICATION FOR AN ORDER APPROVING A CORPORATE REORGANIZATION TO CREATE A HOLDING COMPANY, AVA FORMATION CORP.; CASE NOS. AVU-G-06-1 AND AVU-E-06-1

On February 16, 2006, Avista Corporation ("Avista" or "Company") filed an Application with the Idaho Public Utilities Commission ("Commission") seeking an order for authority to conduct a corporate reorganization and form a holding company to be known as AVA Formation Corp. This Commission has jurisdiction over such request pursuant to *Idaho Code* § 61-328.

On April 28, 2006, the Commission issued a Notice of Application, Notice of Workshop and Notice of Modified Procedure, seeking comments from any interested persons. *See* Order No. 30026. The Order specifically set forth that a public workshop would be held on May 16, 2006 to discuss issues arising from the Application. No person or entity petitioned to intervene in the matter.

BACKGROUND

In its Application, Avista has requested an order granting the Company authority to modify its current corporate structure through the establishment of a holding company. The holding company, AVA Formation Corp. (the "Parent Corporation"), would be formed as the parent company of the existing regulated company, Avista Corporation. The Parent Corporation would also be a parent company of Avista Capital, Inc., which would continue to hold non-regulated subsidiaries.

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.

Avista states that due to the recent repeal of the Public Utilities Holding Company Act of 1935 (PUHCA), the Company considers it to be in the best interest of customers and shareholders to change the corporate structure of Avista into a holding company structure. 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.

Staff issued two requests for production to the Company, and received timely responses. The information provided by the Company primarily addressed the intention and ability of the Company to implement measures to maintain separation between the utility and the non-regulated businesses that would result if the reorganization is approved.

THE STIPULATION

Pursuant to Order No. 30026, representatives of the parties conducted a public workshop on May 16, 2006, and engaged in discussions focusing on key protections for ratepayers with a view toward resolving issues arising from the Application. No other persons attended the meeting. Based upon the discussions between the parties as a compromise of the positions in this case, and for other consideration as set forth below, the parties agreed to various commitments that the Company will undertake as part of the reorganization.

The settlement Stipulation contains 33 “commitments” or conditions that the Company commits to perform in support of the Application. The commitments address the need for ring-fencing, allow the Commission and Staff substantial access to the books and records of the utility and Parent Corporation, set forth cost allocation methodologies, and address equity building mechanisms and dividend payments. The Stipulation parties assert that the commitments satisfy the statutory standards for the Company’s reorganization as set out in *Idaho Code* § 61-328. Stipulation at § 9. In the Motion that accompanied the Stipulation, the parties urged the Commission to adopt the Stipulation, its commitments, and issue an Order approving the reorganization.

The Company will need to approach other states to seek their approval of the reorganization. The settlement Stipulation also contains a “most favored nations” provision.

Stipulation at § 7. This provision allows the Commission to review and adopt any commitment or condition ordered by the other states, even after an Order in this matter is issued. Thus, any assurances, conditions or benefits adopted in the other states that would create a benefit to Idaho customers could subsequently be adopted in Idaho under the terms of the Stipulation.

The parties to the Stipulation recommend that the Commission approve and adopt the commitments in their entirety. They further agree not to appeal any portion of the Stipulation or any Order approving the same. The Stipulation parties also recognize that approval of the Stipulation and commitments 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, in any particular construction project expenditures or actions referred to in (the) Commitments.”

COMMENTS

Comments to the Application were received from a member of the public and from the Commission Staff. The member of the public is a customer and shareholder of the Company. The customer expressed concern that the Parent Corporation may be unable to resolve bad loans it may procure without negatively impacting the utility company. The customer urged the Commission to deny the Company’s Application.

Staff believes that the Application along with the commitments in the Stipulation meet the requirements set forth under *Idaho Code* § 61-328. It is Staff’s belief that Commitment Nos. 1, 4, 8, 9, 10, 11, 15, 17, 18, 19, 29, 30, and 31 address the need for ring-fencing, with provisions ranging from 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. Additionally, Commitment Nos. 2, 3, 5, 13, 23, and 24 provide Staff with access to a full range of books, records and other documents which would pertain to Avista Utilities and its affiliates, including the Parent Corporation. Comprehensive reporting requirements are also included in the commitments that would require the Parent Corporation and Avista Utilities to report to Staff and request approval from the Commission when certain events occur, such as the procurement of loans, the spin-off of any entity, the dissolution of business activities, dividend payment arrangements, and changes in the credit ratings of each entity.

In addition, Staff supports the commitments that include comprehensive arrangements for complying with cost allocation methodologies, as well as commitments involving the payment of dividends. 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.

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 intercompany 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.

Staff believes that 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.

Further, Staff believes that the commitments 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 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 thereto. Staff believes that these Commitments adequately protect Idaho ratepayers and serve the public interest.

COMMISSION DECISION

Does the Commission desire to accept and approve the Application and the Stipulation filed by the parties?



Cecelia A. Gassner

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