AVISTA CORP
Form 10-Q
August 07, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-3701

AVISTA CORPORATION

(Exact name of registrant as specified in its charter)

Washington	**91-0462470**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1411 East Mission Avenue, Spokane, Washington	**99202-2600**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 509-489-0500

Web site: http://www.avistacorp.com

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ¨ No x

As of July 31, 2009, 54,692,465 shares of Registrant s Common Stock, no par value (the only class of common stock), were outstanding.

Table of Contents

AVISTA CORPORATION

Index

		Page No.
Part I. Financial Information:		
Item 1.	Condensed Consolidated Financial Statements	
	Condensed Consolidated Statements of Income - Three Months Ended June 30, 2009 and 2008	3
	Condensed Consolidated Statements of Income - Six Months Ended June 30, 2009 and 2008	4
	Condensed Consolidated Statements of Comprehensive Income - Three and Six Months Ended June 30, 2009 and 2008	5
	Condensed Consolidated Balance Sheets - June 30, 2009 and December 31, 2008	6
	Condensed Consolidated Statements of Cash Flows - Six Months Ended June 30, 2009 and 2008	8
	Condensed Consolidated Statements Stockholders Equity - Six Months Ended June 30, 2009 and 2008	9
	Notes to Condensed Consolidated Financial Statements	10
	Report of Independent Registered Public Accounting Firm	33
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	34
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	63
Item 4.	Controls and Procedures	63
Part II. Other Information:		
Item 1.	Legal Proceedings	64
Item 1A.	Risk Factors	64
Item 4.	Submission of Matters to a Vote of Security Holders	64
Item 6.	Exhibits	65
Signature		66

FORWARD-LOOKING STATEMENTS

Our Quarterly Report on Form 10-Q contains forward-looking statements, which should be read with the cautionary statements and important factors included at Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements on pages 34-35. Forward-looking statements are all statements except those of historical fact, including, without limitation, those that are identified by the use of words that include will, may, could, should, intends, plans, seeks, anticipates, estimates, expects, predicts, and similar expressions. All forward-looking statements are subject to a variety of risks and uncertainties and other factors. Many of these factors are beyond our control and could have a significant effect on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in our statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Three Months Ended June 30

Dollars in thousands, except per share amounts

(Unaudited)

	2009	2008
Operating Revenues:		
Utility revenues	$ 279,865	$ 326,645
Non-utility energy marketing and trading revenues	5,593	5,828
Other non-utility revenues	21,653	17,837
Total operating revenues	307,111	350,310
Operating Expenses:		
Utility operating expenses:		
Resource costs	125,651	183,075
Other operating expenses	57,489	52,520
Depreciation and amortization	23,180	21,914
Taxes other than income taxes	17,482	15,223
Non-utility operating expenses:		
Resource costs	5,341	5,535
Other operating expenses	18,516	14,500
Depreciation and amortization	1,370	1,053
Total operating expenses	249,029	293,820
Income from operations	58,082	56,490
Other Income (Expense):		
Interest expense	(16,160)	(20,750)
Interest expense to affiliated trusts	(253)	(1,520)
Capitalized interest	449	909
Other income (expense) - net	(210)	1,728
Total other income (expense)-net	(16,174)	(19,633)
Income before income taxes	41,908	36,857
Income taxes	15,619	13,305
Net income	26,289	23,552
Less: Net income attributable to noncontrolling interests	(437)	(7)
Net income attributable to Avista Corporation	$ 25,852	$ 23,545
Weighted-average common shares outstanding (thousands), basic	54,654	53,301

Weighted-average common shares outstanding (thousands), diluted		54,827		53,704
Earnings per common share attributable to Avista Corporation:				
Basic	$	0.47	$	0.44
Diluted	$	0.47	$	0.44
Dividends paid per common share	$	0.210	$	0.165

The Accompanying Notes are an Integral Part of These Statements.

3

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Six Months Ended June 30

Dollars in thousands, except per share amounts

(Unaudited)

	2009	**2008**
Operating Revenues:		
Utility revenues	$ 740,730	$ 798,917
Non-utility energy marketing and trading revenues	11,589	12,244
Other non-utility revenues	42,262	35,456
Total operating revenues	794,581	846,617
Operating Expenses:		
Utility operating expenses:		
Resource costs	415,343	501,301
Other operating expenses	115,222	104,239
Depreciation and amortization	46,103	43,356
Taxes other than income taxes	44,377	40,308
Non-utility operating expenses:		
Resource costs	11,068	11,455
Other operating expenses	35,809	28,345
Depreciation and amortization	2,732	2,062
Total operating expenses	670,654	731,066
Income from operations	123,927	115,551
Other Income (Expense):		
Interest expense	(31,748)	(39,679)
Interest expense to affiliated trusts	(1,611)	(3,216)
Capitalized interest	998	1,750
Other income (expense) - net	(770)	2,904
Total other income (expense)-net	(33,131)	(38,241)
Income before income taxes	90,796	77,310
Income taxes	33,087	28,394
Net income	57,709	48,916
Less: Net income attributable to noncontrolling interests	(830)	(140)
Net income attributable to Avista Corporation	$ 56,879	$ 48,776
Weighted-average common shares outstanding (thousands), basic	54,635	53,160

Weighted-average common shares outstanding (thousands), diluted		54,775		53,543
Earnings per common share attributable to Avista Corporation:				
Basic	$	1.04	$	0.92
Diluted	$	1.04	$	0.91
Dividends paid per common share	$	0.39	$	0.33

The Accompanying Notes are an Integral Part of These Statements.

4

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Avista Corporation

For the Three Months Ended June 30

Dollars in thousands

(Unaudited)

	2009	2008
Net income	$ 26,289	$ 23,552
Other Comprehensive Income:		
Change in unfunded benefit obligation for pension plan - net of taxes of $54 and $64 respectively	100	119
Total other comprehensive income	100	119
Comprehensive income	26,389	23,671
Comprehensive income attributable to noncontrolling interests	(437)	(7)
Comprehensive income attributable to Avista Corporation	$ 25,952	$ 23,664

For the Six Months Ended June 30

Dollars in thousands

(Unaudited)

	2009	2008
Net income	$ 57,709	$ 48,916
Other Comprehensive Income (Loss):		
Unrealized losses on interest rate swap agreements - net of taxes of $(2,063)		(3,831)
Reclassification adjustment for realized losses on interest rate swap agreements deferred as a regulatory asset (included in long-term debt) - net of taxes of $5,738		10,657
Change in unfunded benefit obligation for pension plan - net of taxes of $108 and $301 respectively	201	559
Total other comprehensive income	201	7,385
Comprehensive income	57,910	56,301
Comprehensive income attributable to noncontrolling interests	(830)	(140)
Comprehensive income attributable to Avista Corporation	$ 57,080	$ 56,161

The Accompanying Notes are an Integral Part of These Statements.

Table of Contents

CONDENSED CONSOLIDATED BALANCE SHEETS

Avista Corporation

Dollars in thousands

(Unaudited)

	June 30, 2009	December 31, 2008
Assets:		
Current Assets:		
Cash and cash equivalents	$ 34,458	$ 24,313
Accounts and notes receivable-less allowances of $42,275 and $45,062	127,926	218,846
Utility energy commodity derivative assets	2,467	11,234
Regulatory asset for utility derivatives	54,268	60,229
Funds held for customers	53,358	59,095
Materials and supplies, fuel stock and natural gas stored	42,510	53,526
Deferred income taxes	17,608	18,561
Income taxes receivable		22,769
Other current assets	24,360	13,654
Total current assets	356,955	482,227
Net Utility Property:		
Utility plant in service	3,449,736	3,343,535
Construction work in progress	47,372	77,487
Total	3,497,108	3,421,022
Less: Accumulated depreciation and amortization	966,171	928,831
Total net utility property	2,530,937	2,492,191
Other Property and Investments:		
Investment in exchange power-net	24,908	26,133
Investment in affiliated trusts	11,547	13,403
Goodwill	20,509	21,132
Other property and investments-net	80,298	78,208
Total other property and investments	137,262	138,876
Deferred Charges:		
Regulatory assets for deferred income taxes	99,794	115,005
Regulatory assets for pensions and other postretirement benefits	166,515	172,278
Other regulatory assets	83,932	85,112
Non-current utility energy commodity derivative assets	46,873	49,313
Power cost deferrals	38,239	57,607
Unamortized debt expense	30,493	33,004
Other deferred charges	6,842	5,134

Total deferred charges	472,688	517,453
Total assets	$ 3,497,842	$ 3,630,747

The Accompanying Notes are an Integral Part of These Statements.

Table of Contents

CONDENSED CONSOLIDATED BALANCE SHEETS - continued

Avista Corporation

Dollars in thousands

(Unaudited)

	June 30, 2009	December 31, 2008
Liabilities and Stockholders Equity:		
Current Liabilities:		
Accounts payable	$ 104,419	$ 176,116
Customer fund obligations	53,358	59,095
Current portion of long-term debt	17,136	17,207
Short-term borrowings	263,400	252,200
Interest accrued	11,249	10,871
Utility energy commodity derivative liabilities	56,735	71,463
Other current liabilities	115,539	101,592
Total current liabilities	621,836	688,544
Long-term debt	810,106	809,258
Long-term debt to affiliated trusts	51,547	113,403
Other Non-Current Liabilities and Deferred Credits:		
Regulatory liability for utility plant retirement costs	215,908	213,747
Non-current regulatory liability for utility derivatives	38,465	42,172
Pensions and other postretirement benefits	157,334	184,588
Deferred income taxes	463,962	488,940
Other non-current liabilities and deferred credits	96,152	82,006
Total other non-current liabilities and deferred credits	971,821	1,011,453
Total liabilities	2,455,310	2,622,658
Commitments and Contingencies (See Notes to Condensed Consolidated Financial Statements)		
Stockholders Equity:		
Avista Corporation Stockholders Equity:		
Common stock, no par value; 200,000,000 shares authorized; 54,670,665 and 54,487,574 shares outstanding	774,889	774,986
Accumulated other comprehensive loss	(5,891)	(6,092)
Retained earnings	264,027	227,989
Total Avista Corporation stockholders equity	1,033,025	996,883
Noncontrolling interests	9,507	11,206

Total stockholders equity	1,042,532	1,008,089
Total liabilities and stockholders equity	$ 3,497,842	$ 3,630,747

The Accompanying Notes are an Integral Part of These Statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Avista Corporation

For the Six Months Ended June 30

Dollars in thousands

(Unaudited)

	2009	2008
Operating Activities:		
Net income	$ 57,709	$ 48,916
Non-cash items included in net income:		
Depreciation and amortization	48,835	45,418
Provision (benefit) for deferred income taxes	(8,990)	2,058
Power and natural gas cost amortizations, net of deferrals	39,981	23,949
Amortization of debt expense	2,842	2,542
Equity-related AFUDC	(1,232)	(1,858)
Other	13,189	11,214
Contributions to defined benefit pension plan	(32,000)	(14,000)
Changes in working capital components:		
Accounts and notes receivable	93,664	(44,056)
Materials and supplies, fuel stock and natural gas stored	11,016	(11,108)
Other current assets	13,426	9,352
Accounts payable	(66,058)	(23,301)
Deposits from counterparties		66,730
Other current liabilities	4,088	(3,801)
Net cash provided by operating activities	176,470	112,055
Investing Activities:		
Utility property capital expenditures (excluding equity-related AFUDC)	(87,900)	(90,782)
Other capital expenditures	(1,640)	(2,049)
Decrease in restricted cash		4,068
Decrease (increase) in funds held for customers	5,737	(689)
Repayments received on notes receivable		3,009
Purchase of subsidiary minority interest	(4,775)	(6,620)
Other	23	(1,459)
Net cash used in investing activities	(88,555)	(94,522)
Financing Activities:		
Increase in short-term borrowings	11,200	48,500
Proceeds from issuance of long-term debt		249,165
Redemption and maturity of long-term debt	(160)	(293,539)
Redemption of long-term debt to affiliated trusts	(61,856)	
Long-term debt and short-term borrowing issuance costs	(407)	(2,195)
Cash paid in interest rate swap agreement		(16,395)
Issuance of common stock	485	7,374

Cash dividends paid	(21,335)	(17,587)
Increase (decrease) in customer fund obligations	(5,737)	689
Equity transactions of consolidated subsidiaries	40	
Net cash used in financing activities	(77,770)	(23,988)
Net increase (decrease) in cash and cash equivalents	10,145	(6,455)
Cash and cash equivalents at beginning of period	24,313	11,839
Cash and cash equivalents at end of period	$ 34,458	$ 5,384
Supplemental Cash Flow Information:		
Cash paid during the period:		
Interest	$ 28,528	$ 37,293
Income taxes	$ 11,986	$ 19,517

The Accompanying Notes are an Integral Part of These Statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Avista Corporation

For the Six Months Ended June 30, 2009 and 2008

Dollars in thousands

(Unaudited)

	Common Stock						
	Shares	Amount	Accumulated Other Comprehensive Loss	Retained Earnings	Total Avista Corporation Stockholders Equity	Non-Controlling Interests	Total Stockholders Equity
Balance as of January 1, 2009	54,487,574	$ 774,986	$ (6,092)	$ 227,989	$ 996,883	$ 11,206	$ 1,008,089
Net income				56,879	56,879	830	57,709
Equity compensation expense		1,270			1,270		1,270
Issuance of common stock	183,091	485			485		485
Other comprehensive income			201		201		201
Cash dividends paid				(21,335)	(21,335)		(21,335)
Equity transactions of consolidated subsidiaries		(1,852)			(1,852)	(2,182)	(4,034)
Liability to subsidiary minority shareholders				494	494		494
Other						(347)	(347)
Balance as of June 30, 2009	54,670,665	$ 774,889	$ (5,891)	$ 264,027	$ 1,033,025	$ 9,507	$ 1,042,532
Balance as of January 1, 2008	52,909,013	$ 726,933	$ (19,608)	$ 206,641	$ 913,966	$ 862	$ 914,828
Net income				48,776	48,776	140	48,916
Equity compensation expense		1,220			1,220		1,220
Issuance of common stock	586,507	7,374			7,374		7,374
Other comprehensive income			7,385		7,385		7,385
Cash dividends paid				(17,587)	(17,587)		(17,587)
Equity transactions of consolidated subsidiaries		(1,944)			(1,944)	(905)	(2,849)
Liability to subsidiary minority shareholders				6,631	6,631		6,631
Balance as of June 30, 2008	53,495,520	$ 733,583	$ (12,223)	$ 244,461	$ 965,821	$ 97	$ 965,918

The Accompanying Notes are an Integral Part of These Statements.

AVISTA CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The accompanying condensed consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended June 30, 2009 and 2008 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The Condensed Consolidated Statements of Income for the interim periods are not necessarily indicative of the results to be expected for the full year. These condensed consolidated financial statements do not contain the detail or footnote disclosure concerning accounting policies and other matters which would be included in full fiscal year consolidated financial statements; therefore, they should be read in conjunction with the Company s audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008 (2008 Form 10-K). Please refer to the section Acronyms and Terms in the 2008 Form 10-K for definitions of terms such as capacity, energy and therm. The acronyms and terms are an integral part of these condensed consolidated financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Avista Corp. is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. Avista Utilities is an operating division of Avista Corp., comprising the regulated utility operations. Avista Utilities generates, transmits and distributes electricity in parts of eastern Washington and northern Idaho. In addition, Avista Utilities has electric generating facilities in Montana and northern Oregon. Avista Utilities also provides natural gas distribution service in parts of eastern Washington and northern Idaho, as well as parts of northeast and southwest Oregon. Avista Capital, Inc. (Avista Capital), a wholly owned subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility businesses including Advantage IQ, Inc. (Advantage IQ), a 76 percent (as of June 30, 2009) owned subsidiary. Advantage IQ is a provider of facility information and cost management services for multi-site customers throughout North America. See Note 13 for business segment information.

Basis of Reporting

The condensed consolidated financial statements include the assets, liabilities, revenues and expenses of the Company and its subsidiaries, including Advantage IQ and other majority owned subsidiaries and variable interest entities for which the Company or its subsidiaries are the primary beneficiaries. Intercompany balances were eliminated in consolidation. The accompanying condensed financial statements include the Company s proportionate share of utility plant and related operations resulting from its interests in jointly owned plants.

Taxes Other Than Income Taxes

Taxes other than income taxes include state excise taxes, city occupational and franchise taxes, real and personal property taxes and certain other taxes not based on net income. These taxes are generally based on revenues or the value of property. Utility related taxes collected from customers (primarily state excise taxes and city utility taxes) are recorded as operating revenue and expense and totaled $13.0 million for the three months ended June 30, 2009 and $12.4 million for the three months ended June 30, 2008. These taxes were $34.3 million for the six months ended June 30, 2009 and $31.6 million for the six months ended June 30, 2008.

Other Income (expense)-Net

Other income (expense)-net consisted of the following items for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Interest income	$ 413	$ 1,618	$ 901	$ 1,834
Interest on power and natural gas deferrals	719	1,172	1,467	2,140
Equity-related Allowance for Funds Used During Construction	555	965	1,231	1,858
Net loss on investments	(261)		(1,009)	(94)
Other expense	(1,656)	(2,273)	(3,386)	(3,098)
Other income	20	246	26	264
Total other income (expense) - net	$ (210)	$ 1,728	$ (770)	$ 2,904

AVISTA CORPORATION

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, net of tax, consisted of the following as of June 30, 2009 and December 31, 2008 (dollars in thousands):

	June 30, 2009	December 31, 2008
Unfunded benefit obligation for pensions and other postretirement benefit plans	$ (5,891)	$ (6,092)

Goodwill

Goodwill arising from acquisitions represents the excess of the purchase price over the estimated fair value of net assets acquired. The Company evaluates goodwill for impairment using a discounted cash flow model on at least an annual basis or more frequently if impairment indicators arise. The Company completed its annual evaluation of goodwill for potential impairment as of November 30, 2008 for the Other businesses and as of December 31, 2008 for Advantage IQ and determined that goodwill was not impaired at that time.

The changes in the carrying amount of goodwill are as follows: (dollars in thousands):

	Advantage IQ	Other	Total
Balance as of December 31, 2008	$ 15,886	$ 5,246	$ 21,132
Adjustments	(623)		(623)
Balance as of the June 30, 2009	$ 15,263	$ 5,246	$ 20,509

The adjustment to goodwill (recorded in the first quarter of 2009) represents final purchase accounting adjustments for Advantage IQ s acquisition of Cadence Network based upon the completion of the review of the fair market values of relevant assets and liabilities identified as of the acquisition date.

Other Intangibles

Other Intangibles primarily represent the amounts assigned to client relationships related to the Advantage IQ acquisition of Cadence Network (estimated amortization period of 16 years), software development costs (estimated amortization period of 5 to 7 years) and other. Other Intangibles are included in other properties and investments-net on the Condensed Consolidated Balance Sheets. Amortization expense related to Other Intangibles for the three months ended June 30, 2009 and 2008 was $0.5 million and $0.1 million, respectively. Amortization expense related to Other Intangibles for the six months ended June 30, 2009 and 2008 was $0.9 million and $0.3 million, respectively.

The gross carrying amount and accumulated amortization of Other Intangibles as of June 30, 2009 and December 31, 2008 are as follows (dollars in thousands):

	June 30, 2009	December 31, 2008
Client relationships	$ 8,909	$ 8,909
Software development costs	15,228	14,067
Other	570	570

Total other intangibles	24,707	23,546
Less accumulated amortization	(6,710)	(5,804)
Total other intangibles - net	$ 17,997	$ 17,742

The following table details the future estimated amortization expense related to Other Intangibles (dollars in thousands):

	2009	2010	2011	2012	2013
Estimated amortization expense	$ 1,332	$ 2,758	$ 2,556	$ 2,431	$ 2,153

Regulatory Deferred Charges and Credits

The Company prepares its condensed consolidated financial statements in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation. The Company prepares its condensed financial statements in accordance with SFAS No. 71 because:

rates for regulated services are established by or subject to approval by independent third-party regulators,

AVISTA CORPORATION

- the regulated rates are designed to recover the cost of providing the regulated services, and
- in view of demand for the regulated services and the level of competition, it is reasonable to assume that rates can be charged to and collected from customers at levels that will recover costs.

SFAS No. 71 requires the Company to reflect the impact of regulatory decisions in its condensed financial statements. SFAS No. 71 requires that certain costs and/or obligations (such as incurred power and natural gas costs not currently recovered through rates, but expected to be recovered in the future) are reflected as deferred charges or credits on the Condensed Consolidated Balance Sheets. These costs and/or obligations are not reflected in the statement of income until the period during which matching revenues are recognized.

If at some point in the future the Company determines that it no longer meets the criteria for continued application of SFAS No. 71 for all or a portion of its regulated operations, the Company could be:

- required to write off its regulatory assets, and
- precluded from the future deferral of costs not recovered through rates at the time such costs are incurred, even if the Company expected to recover such costs in the future.

The Company s primary regulatory assets include:

- power cost deferrals,
- investment in exchange power,
- regulatory asset for deferred income taxes,
- unamortized debt expense,
- assets offsetting net utility energy commodity derivative liabilities (see Note 4 for further information),
- expenditures for demand side management programs,
- expenditures for conservation programs,
- payments to the Coeur d Alene Tribe for past water storage, and

- unfunded pensions and other postretirement benefits.

Those items without a specific line on the Condensed Consolidated Balance Sheets are included in other regulatory assets.

Regulatory liabilities include:

- utility plant retirement costs,
- natural gas deferrals, and
- liabilities offsetting net utility energy commodity derivative assets (see Note 4 for further information).

Those items without a specific line on the Condensed Consolidated Balance Sheets are included in other current liabilities and other non-current liabilities and deferred credits.

NOTE 2. NEW ACCOUNTING STANDARDS

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements related to its financial assets and liabilities and nonfinancial assets and liabilities measured at fair value on a recurring basis. In February 2008, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) No. 157-2, which deferred the effective date for certain portions of SFAS No. 157 related to nonrecurring measurements of nonfinancial assets and liabilities. Effective January 1, 2009, the Company adopted those provisions of SFAS No. 157. The adoption of the provisions of SFAS No. 157 that became effective on January 1, 2008 and 2009, did not have a material impact on the Company s financial condition, results of operations, and cash flows. However, the Company expanded disclosures with respect to fair value measurements that became effective on January 1, 2008. There were no additional disclosures related to the provisions that became effective January 1, 2009. See Note 9 for the expanded disclosures.

Effective January 1, 2009, the Company adopted SFAS No. 141(R), Business Combinations. This statement replaces SFAS No. 141 and addresses the accounting for all transactions or other events in which an entity obtains control of one or more businesses. This statement requires the acquiring entity in a business combination to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the transaction at the acquisition date, measured at their fair values as of that date, with limited exceptions. The adoption of SFAS No. 141(R) did not have any impact on the Company s financial condition, results of operations, and cash flows.

Table of Contents

AVISTA CORPORATION

Effective January 1, 2009, the Company adopted SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. This statement amends Accounting Research Bulletin No. 51, Consolidated Financial Statements, to establish accounting and reporting standards for a noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership in the consolidated entity that should be reported as equity in the consolidated financial statements. The adoption of SFAS No. 160 did not have any material impact on the Company s financial condition and results of operations. However, it did impact the presentation and disclosure of noncontrolling (minority) interests in the Company s condensed consolidated financial statements. The presentation and disclosure requirements were retrospectively applied to the condensed consolidated financial statements. The Company included $9.5 million of noncontrolling (minority) interests in equity as of June 30, 2009 and $11.2 million as of December 31, 2008. The Company had a reduction to net income attributable to noncontrolling (minority) interests of $0.4 million for the three months ended June 30, 2009 and less than $0.1 million for the three months ended June 30, 2008. The Company had a reduction to net income attributable to noncontrolling (minority) interests of $0.8 million for the six months ended June 30, 2009 and $0.1 million for the six months ended June 30, 2008. The noncontrolling (minority) interests primarily relates to third party shareholders of Advantage IQ, who own approximately 24 percent as of June 30, 2009.

Effective January 1, 2009, the Company adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. This statement requires disclosure of the fair value of derivative instruments and their gains and losses in a tabular format. The statement requires disclosure of derivative features that are related to credit risk. The Company expanded disclosures with respect to derivatives and hedging activities. See Note 4 for the expanded disclosures.

In December 2008, the FASB issued FSP FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends FASB Statement No. 132(R) Employers Disclosures about Pensions and Other Postretirement Benefits. This statement provides guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. The Company will be required to adopt FSP FAS 132(R)-1 at the end of 2009 and will have expanded disclosures with respect to its pension and other postretirement benefit plan assets.

Effective June 30, 2009, the Company adopted FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies, as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. The Company expanded disclosures with respect to the fair value of financial instruments. See Note 9 for the expanded disclosures.

Effective June 30, 3009, the Company adopted FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly . This FSP provides guidance for determining fair values of financial instruments for which there is no active market or quoted prices may represent distressed transactions. The guidance includes a reaffirmation of the need to use judgment in certain circumstances and requires expanded disclosures surrounding equity and debt securities. The adoption of the standard did not have an impact on the Company s financial condition, results of operations, and cash flows. See Note 9 for expanded disclosures.

Effective June 30, 2009, the Company adopted SFAS No. 165, Subsequent Events. This statement established principles and requirements for subsequent events related to: 1) the period after the balance sheet date during which management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; 2) the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements; and 3) the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. The Company evaluated subsequent events through August 7, 2009 (the date the financial statements were issued).

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. This statement amends certain provisions of SFAS No. 140 to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial positions, financial performance,

AVISTA CORPORATION

and cash flows: and a transferor s continuing involvement in transferred financial assets. The Company will be required to adopt SFAS No. 166 effective January 1, 2010. The Company is evaluating the impact SFAS No. 166 will have on its financial condition and results of operations.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). This Statement carries forward the scope of FASB Interpretation No. 46(R), with the addition of entities previously considered qualifying special-purpose entities, as the concept of these entities was eliminated in FASB Statement No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. The Company will be required to adopt SFAS No. 167 effective January 1, 2010. The Company is evaluating the impact SFAS No. 167 will have on its financial condition and results of operations.

In June 2009, the FASB approved the FASB Accounting Standards Codification (the Codification) as the single source of authoritative nongovernmental U.S. GAAP. The Codification will be effective for interim and annual periods ending after September 15, 2009. All existing accounting standard documents will be superseded. All other accounting literature not included in the Codification will be considered nonauthoritative. The Company will be required to adopt the Codification September 30, 2009. The Company does not expect the adoption of the Codification to have any impact on the Company s financial condition, results of operations, and cash flows. However, the adoption will remove references to specific accounting literature that is currently included in the Company s financial statements.

NOTE 3. ACCOUNTS RECEIVABLE SALE

Avista Receivables Corporation (ARC) is a wholly owned, bankruptcy-remote subsidiary of Avista Corp. formed for the purpose of acquiring or purchasing interests in certain accounts receivable, both billed and unbilled, of the Company. Avista Corp., ARC and a third-party financial institution are parties to a Receivables Purchase Agreement, and on March 13, 2009 that agreement was amended to among other things, extend the termination date to March 12, 2010. Under the Receivables Purchase Agreement, ARC can sell without recourse, and such financial institution will purchase, on a revolving basis, up to $85.0 million of those receivables. ARC is obligated to pay fees that approximate the purchaser s cost of issuing commercial paper equal in value to the interests in receivables sold. On a consolidated basis, the amount of such fees is included in other operating expenses of Avista Corp. The Receivables Purchase Agreement has financial covenants, which are substantially the same as those of Avista Corp. s committed lines of credit (see Note 6). Based on calculations of eligible receivables, ARC had the ability to sell up to $56.0 million of receivables under this revolving agreement at June 30, 2009 and $85.0 million at December 31, 2008. There were $14.0 million in accounts receivable sold under this revolving agreement as of June 30, 2009 and $17.0 million as of December 31, 2008.

The Receivables Purchase Agreement requires a receivables report to be prepared on a monthly basis, including information related to customer account delinquency ratios. The June 30, 2009 report indicated that one measurement of the delinquency ratios was in excess of the threshold specified in the Receivables Purchase Agreement, triggering an optional liquidation event. An optional liquidation event gives the receivables purchaser the right, at its option, to terminate its obligations to purchase additional receivables from ARC. Avista Corp, ARC and the third-party financial institution have executed an amendment to the Receivables Purchase Agreement which waived the occurrence of the liquidation event arising from the customer account delinquency ratio increase reflected in the June 30, 2009 report and made certain other amendments to the Receivables Purchase Agreement, including an increase in the delinquency ratio threshold for the periods to be covered by the July 31, 2009 and August 31, 2009 monthly receivables reports and the modification of certain reporting obligations.

NOTE 4. DERIVATIVES AND RISK MANAGEMENT

Energy Commodity Derivatives

Avista Utilities is exposed to market risks relating to changes in electricity and natural gas commodity prices and certain other fuel prices. Market risk is, in general, the risk of fluctuation in the market price of the commodity being traded and is influenced primarily by supply and demand. Market risk includes the fluctuation in the market price of associated derivative commodity instruments. Market risk may also be influenced by market participants nonperformance of their contractual obligations and commitments, which affects the supply of, or demand for, the commodity. Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options in order to manage the various risks relating to these commodity price exposures. The Company has an energy resources risk policy and control procedures to manage these risks. The Company s Risk Management Committee establishes the

14

Table of Contents

AVISTA CORPORATION

Company s energy resources risk policy and monitors compliance. The Risk Management Committee is comprised

of certain Company officers and other management. The Audit Committee of the Company s Board of Directors periodically reviews and discusses risk assessment and risk management policies, including the Company s material financial and accounting risk exposures and the steps management has undertaken to control them.

As part of its resource procurement and management operations in the electric business, Avista Utilities engages in an ongoing process of resource optimization, which involves the economic selection from available energy resources to serve Avista Utilities load obligations and using these resources to capture available economic value. Avista Utilities sells and purchases wholesale electric capacity and energy and fuel as part of the process of acquiring and balancing resources to serve its load obligations. These transactions range from terms of one hour up to multiple years.

Avista Utilities makes continuing projections of:

- electric loads at various points in time (ranging from one hour to multiple years) based on, among other things, estimates of customer usage and weather, historical data and contract terms, and
- resource availability at these points in time based on, among other things, fuel choices and fuel markets, estimates of streamflows, availability of generating units, historic and forward market information, contract terms, and experience.

On the basis of these projections, Avista Utilities makes purchases and sales of electric energy and fuel to match expected resources to expected electric load requirements. Resource optimization involves generating plant dispatch and scheduling available resources and also includes transactions such as:

- purchasing fuel for generation,
- when economical, selling fuel and substituting wholesale purchases for the operation of Avista Utilities resources, and
- other wholesale transactions to capture the value of generation and transmission resources.

Avista Utilities optimization process includes entering into hedging transactions to manage risks.

As part of its resource procurement and management operations in the natural gas business, Avista Utilities makes continuing projections of its natural gas loads and assesses available natural gas resources. Forward natural gas contracts are typically for monthly delivery periods. However, daily variations in natural gas demand can be significantly different than monthly demand projections. On the basis of these projections, Avista Utilities plans and executes a series of transactions to hedge a significant portion of its projected natural gas requirements through forward market transactions and derivative instruments. These transactions may extend as much as four natural gas operating years (November through October) into the future. Avista Utilities also leaves a significant portion of its gas supply requirements un-hedged for purchase in short-term and spot markets. Natural gas resource optimization activities include:

wholesale market sales of surplus gas supplies,

purchases and sales of natural gas to use under-utilized pipeline capacity, and

sales of excess natural gas storage capacity.

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires the recording of all derivatives as either assets or liabilities on the balance sheet measured at estimated fair value and the recognition of the unrealized gains and losses. In certain defined conditions, a derivative may be specifically designated as a hedge for a particular exposure. The accounting for derivatives depends on the intended use of the derivatives and the resulting designation.

In conjunction with the provisions of SFAS No. 133, the WUTC and the IPUC issued accounting orders authorizing Avista Utilities to offset commodity derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of settlement. The orders provide for Avista Utilities to not recognize the unrealized gain or loss on utility derivative commodity instruments in the Condensed Consolidated Statements of Income. Realized gains or losses are recognized in the period of settlement, subject to approval for recovery through retail rates. Realized gains and losses, subject to regulatory approval, result in annual adjustments to retail rates through purchased gas cost adjustments, the Energy Recovery Mechanism (ERM) in Washington, the Power Cost Adjustment (PCA) mechanism in Idaho, and periodic general rates cases.

Table of Contents

AVISTA CORPORATION

Substantially all forward contracts to purchase or sell power and natural gas are recorded as assets or liabilities at market value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives under SFAS No. 133 are generally accounted for on the accrual basis until they are settled or realized, unless there is a decline in the fair value of the contract that is determined to be other than temporary.

The following table presents the underlying energy commodity derivative volumes as of June 30, 2009 that are expected to settle in each respective year (in thousands of MWhs and mmBTUs):

	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
Year	Physical MWH	Financial MWH	Physical mmBTUs	Financial mmBTUs	Physical MWH	Financial MWH	Physical mmBTUs	Financial mmBTUs
2009	1,561	482	11,672	765	525		5,680	
2010	576	482	13,347	1,210	621		1,162	
2011	370		7,805		286			
2012	366		3,396		287			
2013	368		1,575		286			
Thereafter	1,682				1,303			

Foreign Currency Exchange Contracts

A significant portion of Avista Utilities natural gas supply is obtained from Canadian sources. Most of those transactions are executed in U.S. dollars, which avoids foreign currency risk. A growing portion of Avista Utilities short-term natural gas transactions and long-term Canadian transportation contracts are committed based on Canadian currency prices and settled within sixty days with U.S. dollars. In early 2009, Avista Utilities implemented a process to economically hedge a portion of the foreign currency risk by purchasing Canadian currency when such commodity transactions are initiated. This risk has not had a material effect on the Company s financial condition, results of operations or cash flows and these differences in cost related to currency fluctuations were included with natural gas supply costs for ratemaking. As of June 30, 2009, the Company had a current derivative asset for foreign currency hedges of $0.1 million included in other current assets and a current derivative liability for foreign currency hedges of $0.2 million included in other current liabilities on the Condensed Consolidated Balance Sheet. As of June 30, 2009, the Company had entered into 50 Canadian currency forward contracts with a notional amount of $6.9 million ($7.8 million Canadian).

Interest Rate Swap Agreements

Avista Corp. enters into forward-starting interest rate swap agreements to manage the risk associated with changes in interest rates and the impact on future interest payments. These interest rate swap agreements relate to the interest payments for the anticipated issuances of debt. These interest rate swap agreements are considered economic hedges against fluctuations in future cash flows associated with changes in interest rates.

The following table summarizes the interest rate swaps that the Company has entered into as of June 30, 2009 (dollars in thousands):

Entered	Notional	Number of Contracts	Mandatory Cash Settlement Date
December 2008	$ 50,000	2	December 2009
January 2009	50,000	2	December 2009
March 2009	50,000	2	December 2010

Total	$ 150,000

Under the terms of the outstanding interest rate swap agreements, the value of the interest rate swaps is determined based upon Avista Corp. paying a fixed rate and receiving a variable rate based on LIBOR for a term of ten years. As of June 30, 2009, Avista Corp. had a current derivative asset and an offsetting regulatory liability of $9.9 million and a long-term derivative asset and an offsetting regulatory liability of $3.2 million on the Condensed Consolidated Balance Sheets in accordance with regulatory accounting practices. Upon settlement of the interest rate swaps, the regulatory asset or liability (included as part of long-term debt) will be amortized as a component of interest expense over the life of the forecasted interest payments.

AVISTA CORPORATION

Derivative Instruments Summary

The following table presents the fair values and locations of derivative instruments recorded on the Condensed Consolidated Balance Sheet as of June 30, 2009 (in thousands):

	Balance Sheet Location	Fair Value
Asset Derivatives:		
Interest rate contracts	Other current assets	$ 9,887
Interest rate contracts	Other property and investments - net	3,185
Foreign currency contracts	Other current assets	101
Commodity contracts	Current utility energy commodity derivative assets	3,098
Commodity contracts	Current utility energy commodity derivative liabilities	19,210
Commodity contracts	Non-current utility energy commodity derivative assets	62,028
Commodity contracts	Other non-current liabilities and deferred credits	1,708
Total asset derivative instruments recorded on the balance sheet		$ 99,217
Liability Derivatives:		
Foreign currency contracts	Other current liabilities	$ 235
Commodity contracts	Current utility energy commodity derivative assets	631
Commodity contracts	Current utility energy commodity derivative liabilities	75,945
Commodity contracts	Non-current utility energy commodity derivative assets	15,155
Commodity contracts	Other non-current liabilities and deferred credits	10,116
Total liability derivative instruments recorded on the balance sheet		$ 102,082

Exposure to Demands for Collateral

The Company s derivative contracts often require collateral (in the form of cash or letters of credit) or other credit enhancements, or reductions or terminations of a portion of the contract through cash settlement in the event of a downgrade in the Company s credit ratings or adverse changes in market prices.

In periods of price volatility, the level of exposure can change significantly. As a result, sudden and significant demands may be made against the Company s credit facilities and cash. The Company actively monitors the exposure to possible collateral calls and takes steps to minimize capital requirements.

Certain of the Company s derivative instruments contain provisions that require the Company to maintain an investment grade credit rating from the major credit rating agencies. If the Company s credit ratings were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position as of June 30, 2009 was $48.8 million. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2009, the Company would be required to post $22.6 million of collateral to its counterparties.

Credit Risk

Credit risk relates to the potential losses that the Company would incur as a result of non-performance by counterparties of their contractual obligations to deliver energy or make financial settlements. The Company often extends credit to counterparties and customers and is exposed to the risk that it may not be able to collect amounts owed to the Company. Changes in market prices may dramatically alter the size of credit risk with counterparties, even when conservative credit limits are established. Credit risk includes potential counterparty default due to circumstances:

- relating directly to it,
- caused by market price changes, and
- relating to other market participants that have a direct or indirect relationship with such counterparty.

Should a counterparty, customer or supplier fail to perform, the Company may be required to honor the underlying commitment or to replace existing contracts with contracts at then-current market prices. The Company seeks to mitigate credit risk by:

- entering into bilateral contracts that specify credit terms and protections against default,
- applying credit limits and duration criteria to existing and prospective counterparties,

Table of Contents

AVISTA CORPORATION

- actively monitoring current credit exposures, and
- conducting some of its transactions on exchanges with clearing arrangements that essentially eliminate counterparty default risk.

These credit policies include an evaluation of the financial condition and credit ratings of counterparties, collateral requirements or other credit enhancements, such as letters of credit or parent company guarantees. The Company also uses standardized agreements that allow for the netting or offsetting of positive and negative exposures associated with a single counterparty or affiliated group.

The Company has concentrations of suppliers and customers in the electric and natural gas industries including:

- electric utilities,
- electric generators and transmission providers,
- natural gas producers and pipelines,
- financial institutions, and
- energy marketing and trading companies.

In addition, the Company has concentrations of credit risk related to geographic location as it operates in the western United States and western Canada. These concentrations of counterparties and concentrations of geographic location may impact the Company s overall exposure to credit risk, either positively or negatively, because the counterparties may be similarly affected by changes in conditions.

As is common industry practice, Avista Utilities maintains margin agreements with certain counterparties. Margin calls are triggered when exposures exceed predetermined contractual limits or when there are changes in a counterparty s creditworthiness. Price movements in electricity and natural gas can generate exposure levels in excess of these contractual limits. From time to time, margin calls are made and/or received by Avista Utilities. Negotiating for collateral in the form of cash, letters of credit, or performance guarantees is common industry practice.

Cash deposits from counterparties totaled $0.2 million as of June 30, 2009 and December 31, 2008. These funds were held by Avista Utilities to mitigate the potential impact of counterparty default risk. These amounts are subject to return if conditions warrant because of continuing portfolio value fluctuations with those parties or substitution of non-cash collateral.

NOTE 5. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS

The Company has a defined benefit pension plan covering substantially all regular full-time employees at Avista Utilities. Individual benefits under this plan are based upon the employee s years of service and average compensation as specified in the plan. The Company s funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax purposes. The Company contributed $28 million in cash to the pension plan in 2008 and $15 million in each of 2007 and 2006. The Company expects to contribute $48 million to the pension plan in 2009 ($32 million was contributed during the first six months of 2009).

The Company also has a Supplemental Executive Retirement Plan (SERP) that provides additional pension benefits to executive officers of the Company. The SERP is intended to provide benefits to executive officers whose benefits under the pension plan are reduced due to the application of Section 415 of the Internal Revenue Code of 1986 and the deferral of salary under deferred compensation plans. The liability and expense for this plan are included as pension benefits.

The Company provides certain health care and life insurance benefits for substantially all of its retired employees. The Company accrues the estimated cost of postretirement benefit obligations during the years that employees provide services. The liability and expense for this plan are included as other postretirement benefits.

The Company established a Health Reimbursement Arrangement to provide employees with tax-advantaged funds to pay for allowable medical expenses upon retirement. The amount earned by the employee is fixed on the retirement date based on employees years of service and the ending salary. The liability and expense of this plan are included as other postretirement benefits.

AVISTA CORPORATION

The Company provides death benefits to beneficiaries of executive officers who die during their term of office or after retirement. Under the plan, an executive officer s designated beneficiary will receive a payment equal to twice the executive officer s annual base salary at the time of death (or if death occurs after retirement, a payment equal to twice the executive officer s total annual pension benefit). The liability and expense for this plan are included as other postretirement benefits.

The Company uses a December 31 measurement date for its pension and postretirement plans. The following table sets forth the components of net periodic benefit costs for the three and six months ended June 30 (dollars in thousands):

	Pension Benefits		Other Post-retirement Benefits	
	2009	2008	2009	2008
Three months ended June 30:				
Service cost	$ 2,673	$ 2,552	$ 202	$ 149
Interest cost	5,404	5,203	571	469
Expected return on plan assets	(4,238)	(5,274)	(341)	(391)
Transition obligation recognition			126	126
Amortization of prior service cost	164	164	(37)	
Net loss recognition	2,089	659	363	179
Net periodic benefit cost	$ 6,092	$ 3,304	$ 884	$ 532
Six months ended June 30:				
Service cost	$ 5,346	$ 5,105	$ 404	$ 297
Interest cost	10,808	10,406	1,142	938
Expected return on plan assets	(8,476)	(10,548)	(682)	(781)
Transition obligation recognition			252	253
Amortization of prior service cost	328	327	(74)	
Net loss recognition	4,144	1,759	626	244
Net periodic benefit cost	$ 12,150	$ 7,049	$ 1,668	$ 951

NOTE 6. SHORT-TERM BORROWINGS

The Company has a committed line of credit agreement with various banks in the total amount of $320.0 million with an expiration date of April 5, 2011. Under the credit agreement, the Company can request the issuance of up to $320.0 million in letters of credit. The Company had $260.0 million in borrowings outstanding under this committed line of credit as of June 30, 2009 and $250.0 million as of December 31, 2008. Total letters of credit outstanding were $36.7 million as of June 30, 2009 and $24.3 million as of December 31, 2008. The committed line of credit is secured by $320.0 million of non-transferable First Mortgage Bonds of the Company issued to the agent bank that would only become due and payable in the event, and then only to the extent, that the Company defaults on its obligations under the committed line of credit.

Additionally, the Company has a committed line of credit agreement with various banks in the total amount of $200.0 million with an expiration date of November 24, 2009. As of June 30, 2009 and December 31, 2008, the Company did not have any borrowings outstanding under this committed line of credit. The committed line of credit is secured by $200.0 million of non-transferable First Mortgage Bonds of the Company issued to the agent bank that would only become due and payable in the event, and then only to the extent, that the Company defaults on its obligations under the committed line of credit.

The committed line of credit agreements contain customary covenants and default provisions, including a covenant requiring the ratio of earnings before interest, taxes, depreciation and amortization to interest expense of Avista Utilities for the preceding twelve-month period at the end of any fiscal quarter to be greater than 1.6 to 1. As of June 30, 2009, the Company was in compliance with this covenant with a ratio of 3.89 to 1. The committed line of credit agreements also have a covenant which does not permit the ratio of consolidated total debt to consolidated total capitalization of Avista Corp. to be greater than 70 percent at any time. As of June 30, 2009, the Company was in compliance with this covenant with a ratio of 52.3 percent. If the proposed change in organization becomes effective (see Note 12 for potential holding company formation), the committed line of credit agreements will remain at Avista Corp. The committed line of credit agreements also have a covenant which requires the Company to maintain a minimum funded ratio of the pension plan assets to liabilities. The Pension Protection Act of 2006 (that was implemented in 2008) modified the liability calculation utilized to calculate the funded ratio. Avista Corp. amended

Table of Contents

AVISTA CORPORATION

the covenant related to the pension funded ratio, under its $320.0 million committed line of credit agreement, to conform with the calculations under the Pension Protection Act of 2006. The pension funded ratio covenant was included in the $200.0 million committed line of credit agreement.

Advantage IQ

Advantage IQ has a committed credit agreement with a bank that has an expiration date of February 2011. On July 1, 2009, the committed amount was increased from $12.5 million to $15.0 million under the terms of the credit agreement. Advantage IQ has the ability to increase the credit facility to $25 million under the same agreement. The credit agreement is secured by substantially all of Advantage IQ s assets. Advantage IQ had $3.4 million of borrowings outstanding under the credit agreement as of June 30, 2009, and $2.2 million as of December 31, 2008.

NOTE 7. LONG-TERM DEBT

The following details the interest rate and maturity dates of long-term debt outstanding as of June 30, 2009 and December 31, 2008 (dollars in thousands):

Maturity Year	Description	Interest Rate	June 30, 2009	December 31, 2008
2010	Secured Medium-Term Notes	6.67%-8.02%	$ 35,000	$ 35,000
2012	Secured Medium-Term Notes	7.37%	7,000	7,000
2013	First Mortgage Bonds	6.13%	45,000	45,000
2013	First Mortgage Bonds	7.25%	30,000	30,000
2018	First Mortgage Bonds	5.95%	250,000	250,000
2018	Secured Medium-Term Notes	7.39%-7.45%	22,500	22,500
2019	First Mortgage Bonds	5.45%	90,000	90,000
2023	Secured Medium-Term Notes	7.18%-7.54%	13,500	13,500
2028	Secured Medium-Term Notes	6.37%	25,000	25,000
2034	Secured Pollution Control Bonds	(1)	17,000	17,000
2035	First Mortgage Bonds	6.25%	150,000	150,000
2037	First Mortgage Bonds	5.70%	150,000	150,000
	Total secured long-term debt		835,000	835,000
2023	Unsecured Pollution Control Bonds	6.00%	4,100	4,100
	Other long-term debt and capital leases		2,846	3,006
	Interest rate swaps		(13,261)	(14,129)
	Unamortized debt discount		(1,443)	(1,512)
	Total		827,242	826,465
	Current portion of long-term debt		(17,136)	(17,207)
	Total long-term debt		$ 810,106	$ 809,258

(1) Variable interest rate (reset daily) ranging from 0.25 percent to 1.20 percent during the first six months of 2009. As of June 30, 2009 the variable rate was 0.40 percent.

NOTE 8. LONG-TERM DEBT TO AFFILIATED TRUSTS

In 2004, the Company issued Junior Subordinated Debt Securities, with a principal amount of $61.9 million to AVA Capital Trust III, an affiliated business trust formed by the Company. Concurrently, AVA Capital Trust III issued $60.0 million of Preferred Trust Securities to third parties and $1.9 million of Common Trust Securities to the Company. On April 1, 2009, AVA Capital Trust III redeemed all of the Preferred Trust Securities issued to third parties with a principal balance of $60.0 million and all of the Common Trust Securities issued to the Company with a principal balance of $1.9 million. Concurrently, the Company redeemed the total amount outstanding of its Junior Subordinated Debt Securities, at 100 percent of the principal amount ($61.9 million) plus accrued interest held by AVA Capital Trust III. The Company s net redemption of $60.0 million was funded by borrowings under its $320.0 million committed line of credit agreement.

AVISTA CORPORATION

NOTE 9. FAIR VALUE

The carrying values of cash and cash equivalents, restricted cash, accounts and notes receivable, accounts payable and short-term borrowings are reasonable estimates of their fair values. Long-term debt (including current portion, but excluding capital leases) and long-term debt to affiliated trusts are reported at carrying value on the Condensed Consolidated Balance Sheets. The following table sets forth the carrying value and estimated fair value of the Company s financial instruments not reported at estimated fair value on the Condensed Consolidated Balance Sheets as of June 30, 2009 and December 31, 2008 (dollars in thousands):

	June 30, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term debt	$ 839,100	$ 821,896	$ 839,100	$ 875,451
Long-term debt to affiliated trusts	51,547	43,771	113,403	102,027

These estimates of fair value were primarily based on available market information.

Energy commodity derivative assets and liabilities, deferred compensation assets, as well as derivatives related to interest rate swap agreements and foreign currency exchange contracts, are reported at estimated fair value on the Condensed Consolidated Balance Sheets. As disclosed in Note 2, on January 1, 2008, the Company adopted the provisions of SFAS No. 157 related to its financial assets and liabilities and nonfinancial assets and liabilities measured at fair value on a recurring basis, and on January 1, 2009, the Company adopted the provisions of SFAS No. 157 related to nonrecurring measurements of nonfinancial assets and liabilities. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy defined by SFAS No. 157 are as follows:

Level 1 Quoted prices are available in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 Pricing inputs include significant inputs that are generally unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to the Company s needs.

As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Table of Contents

AVISTA CORPORATION

The following table discloses by level within the fair value hierarchy the Company s assets and liabilities measured and reported on the Condensed Consolidated Balance Sheets as of June 30, 2009 and December 31, 2008 at fair value on a recurring basis (dollars in thousands):

	Level 1	Level 2	Level 3	Counterparty Netting	Total
June 30, 2009					
Assets:					
Energy commodity derivatives	$	$ 25,476	$ 60,569	$ (36,705)	$ 49,340
Deferred compensation assets:					
Fixed income securities (1)	1,783				1,783
Equity securities (1)	5,350				5,350
Interest rate swaps		13,072			13,072
Foreign currency derivatives		101			101
Total	$ 7,133	$ 38,649	$ 60,569	$ (36,705)	$ 69,646
Liabilities:					
Energy commodity derivatives	$	$ 87,808	$ 14,040	$ (36,705)	$ 65,143
Foreign currency derivatives		235			235
Total	$	$ 88,043	$ 14,040	$ (36,705)	$ 65,378
December 31, 2008					
Assets:					
Energy commodity derivatives	$	$ 40,104	$ 68,047	$ (47,604)	$ 60,547
Deferred compensation assets:					
Fixed income securities (1)	1,889				1,889
Equity securities (1)	5,101				5,101
Interest rate swaps		875			875
Total	$ 6,990	$ 40,979	$ 68,047	$ (47,604)	$ 68,412
Liabilities:					
Energy commodity derivatives	$	$ 110,123	$ 16,085	$ (47,604)	$ 78,604

(1) These assets are trading securities.

Avista Utilities enters into forward contracts to purchase or sell a specified amount of energy at a specified time, or during a specified period, in the future. These contracts are entered into as part of Avista Utilities management of loads and resources and certain contracts are considered derivative instruments. The difference between the amount of derivative assets and liabilities disclosed in respective levels and the amount of derivative assets and liabilities disclosed on the Condensed Consolidated Balance Sheets is due to netting arrangements with certain counterparties. The Company uses quoted market prices and forward price curves to estimate the fair value of utility derivative commodity instruments included in Level 2. In particular, electric derivative valuations are performed using broker quotes, adjusted for periods in between quotable periods. Natural gas derivative valuations are estimated using New York Mercantile Exchange (NYMEX) pricing for similar instruments, adjusted for basin differences, which are also quoted under NYMEX. Where observable inputs are available for substantially the full term of the contract, the derivative asset or liability is included in Level 2. The Company also has certain contracts that, primarily due to the

length of the respective contract, require the use of internally developed forward price estimates, which include significant inputs that may not be observable or corroborated in the market. These derivative contracts are included in Level 3. Refer to Note 4 for further discussion of the Company s energy commodity derivative assets and liabilities.

Deferred compensation assets and liabilities represent funds held by the Company in a Rabbi Trust for an Executive Deferral Plan. These funds consist of actively traded equity and bond funds with quoted prices in active markets. The balance disclosed excludes cash and cash equivalents of $1.8 million as of June 30, 2009 and December 31, 2008.

AVISTA CORPORATION

The following table presents activity for energy commodity derivative assets measured at fair value using significant unobservable inputs for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Balance as beginning of the period	$ 48,675	$ 132,239	$ 68,047	$ 98,943
Total gains or losses (realized/unrealized):				
Included in net income				
Included in other comprehensive income				
Included in regulatory assets/liabilities (1)	11,894	19,932	(6,326)	57,010
Purchases, issuances, and settlements, net		(1,200)	(1,152)	(4,982)
Transfers to other categories				
Ending balance as of June 30	$ 60,569	$ 150,971	$ 60,569	$ 150,971

The following table presents activity for energy commodity derivative liabilities measured at fair value using significant unobservable inputs for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Balance as of beginning of the period	$ 12,867	$ 46,260	$ 16,085	$ 36,506
Total gains or losses (realized/unrealized):				
Included in net income				
Included in other comprehensive income				
Included in regulatory assets/liabilities (1)	1,674	(24,247)	(1,516)	(14,493)
Purchases, issuances, and settlements, net	(501)	(1,703)	(529)	(1,703)
Transfers to other categories				
Ending balance as of June 30	$ 14,040	$ 20,310	$ 14,040	$ 20,310

(1) In conjunction with the provisions of SFAS No. 133, the WUTC and the IPUC issued accounting orders authorizing Avista Utilities to offset certain derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of settlement. As such, the Company does not recognize unrealized gains or losses on utility energy commodity derivative instruments in the Condensed Consolidated Statements of Income. The Company recognizes realized gains or losses in the period of contract settlement, subject to regulatory approval for recovery through retail rates. Realized gains and losses, subject to regulatory approval, result in annual adjustments to retail rates through purchased gas cost adjustments, the ERM, the PCA mechanism, and periodic general rate cases.

NOTE 10. EARNINGS PER COMMON SHARE

The following table presents the computation of basic and diluted earnings per common share for the three and six months ended June 30 (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Numerator:				
Net income attributable to Avista Corporation	$ 25,852	$ 23,545	$ 56,879	$ 48,776
Subsidiary earnings adjustment for dilutive securities	(18)	(76)	(53)	(151)
Adjusted net income attributable to Avista Corporation for computation of diluted earnings per common share	$ 25,834	$ 23,469	$ 56,826	$ 48,625
Denominator:				
Weighted-average number of common shares outstanding-basic	54,654	53,301	54,635	53,160
Effect of dilutive securities:				
Contingent stock awards	66	192	74	163
Stock options	107	211	66	220
Weighted-average number of common shares outstanding-diluted	54,827	53,704	54,775	53,543

AVISTA CORPORATION

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Earnings per common share attributable to Avista Corporation:				
Total earnings per common share, basic	$ 0.47	$ 0.44	$ 1.04	$ 0.92
Total earnings per common share, diluted	$ 0.47	$ 0.44	$ 1.04	$ 0.91

Total stock options outstanding that were not included in the calculation of diluted earnings per common share were 343,950 for the three and six months ended June 30, 2009, and 300,750 for the three and six months ended June 30, 2008. These stock options were excluded from the calculation because they were antidilutive based on the fact that the exercise price of the stock options was higher than the average market price of Avista Corp. common stock during the respective period.

NOTE 11. COMMITMENTS AND CONTINGENCIES

In the course of its business, the Company becomes involved in various claims, controversies, disputes and other contingent matters, including the items described in this Note. Some of these claims, controversies, disputes and other contingent matters involve litigation or other contested proceedings. With respect to these proceedings, the Company intends to vigorously protect and defend its interests and pursue its rights. However, no assurance can be given as to the ultimate outcome of any particular matter because litigation and other contested proceedings are inherently subject to numerous uncertainties. With respect to matters that affect Avista Utilities operations, the Company intends to seek, to the extent appropriate, recovery of incurred costs through the ratemaking process.

Federal Energy Regulatory Commission Inquiry

In April 2004, the FERC approved the contested Agreement in Resolution of Section 206 Proceeding (Agreement in Resolution) between Avista Corp. doing business as Avista Utilities, Avista Energy and the FERC s Trial Staff which stated that there was: (1) no evidence that any executives or employees of Avista Utilities or Avista Energy knowingly engaged in or facilitated any improper trading strategy during 2000 and 2001; (2) no evidence that Avista Utilities or Avista Energy engaged in any efforts to manipulate the western energy markets during 2000 and 2001; and (3) no finding that Avista Utilities or Avista Energy withheld relevant information from the FERC s inquiry into the western energy markets for 2000 and 2001 (Trading Investigation). The Attorney General of the State of California (California AG), the California Electricity Oversight Board, California Parties and the City of Tacoma, Washington challenged FERC s decisions approving the Agreement in Resolution, which are now pending before the United States Court of Appeals for the Ninth Circuit (Ninth Circuit).

In May 2004, the FERC provided notice that Avista Energy was no longer subject to an investigation reviewing certain bids above $250 per MW in the short-term energy markets operated by the California Independent System Operator (CalISO) and the California Power Exchange (CalPX) from May 1, 2000 to October 2, 2000 (Bidding Investigation). That matter is also pending before the Ninth Circuit, after the California AG, Pacific Gas & Electric (PG&E), Southern California Edison Company (SCE) and the California Public Utilities Commission (CPUC) filed petitions for review in 2005.

Based on the FERC s order approving the Agreement in Resolution and the FERC s denial of rehearing requests, the Company does not expect that this proceeding will have any material adverse effect on its financial condition, results of operations or cash flows. Furthermore, based on information currently know to the Company regarding the Bidding Investigation and the fact that the FERC Staff did not find any evidence of manipulative behavior, the Company does not expect that matter will have a material adverse effect on its financial condition, results of operations or cash flows.

California Refund Proceeding

In July 2001, the FERC ordered an evidentiary hearing to determine the amount of refunds due to California energy buyers for purchases made in the spot markets operated by the CalISO and the CalPX during the period from October 2, 2000 to June 20, 2001 (Refund Period). Proposed refunds are based on the calculation of mitigated market clearing prices (MMCP) for each hour. The FERC ruled that if the refunds required by

the formula would cause a seller to recover less than its actual costs for the Refund Period, sellers may document these costs and limit their refund liability commensurately. In September 2005, Avista Energy submitted its cost filing claim pursuant to

AVISTA CORPORATION

the FERC s August 2005 order. That filing was accepted in orders issued by the FERC in January 2006 and November 2006. In June 2009, the FERC reversed, in part, its previous decision and ordered a compliance filing requiring an adjustment to the return on investment component of Avista Energy s cost filing. That compliance filing was made in July 2009.

The CalISO continues to work on its compliance filing for the Refund Period, which will show who owes what to whom. In May 2009, the CalISO filed its 43rd status report on the California recalculation process confirming that the preparatory and the FERC refund recalculations are complete (as are calculations related to fuel cost allowance offsets, emission offsets, cost-recovery offsets, and the majority of the interest calculations). Once the FERC rules on several open issues, the CalISO states that it intends to: (1) perform the necessary adjustment to remove refunds associated with non-jurisdictional entities and allocate that shortfall to net refund recipients; and (2) work with the parties to the various global settlements to make appropriate adjustments to the CalISO s data in order to properly reflect those adjustments. After completing these calculations, the CalISO states that it intends to make a compliance filing with the FERC that presents the final financial position of each party that participated in its markets during the Refund Period.

The 2001 bankruptcy of PG&E resulted in a default on its payment obligations to the CalPX. As a result, Avista Energy has not been paid for all of its energy sales during the Refund Period. Those funds are now in escrow accounts and will not be released until the FERC issues an order directing such release in the California refund proceeding. As of June 30, 2009, Avista Energy s accounts receivable outstanding related to defaulting parties in California were fully offset by reserves for uncollected amounts and funds collected from defaulting parties.

Many of the orders that the FERC has issued in the California refund proceedings were appealed to the Ninth Circuit. In October 2004, the Ninth Circuit ordered that briefing proceed in two rounds. The first round was limited to three issues: (1) which parties are subject to the FERC s refund jurisdiction in light of the exemption for government-owned utilities in section 201(f) of the Federal Power Act (FPA); (2) the temporal scope of refunds under section 206 of the FPA; and (3) which categories of transactions are subject to refunds. The second round of issues and their corresponding briefing schedules have not yet been set by the Ninth Circuit.

In September 2005, the Ninth Circuit held that the FERC did not have the authority to order refunds for sales made by municipal utilities in the California refund proceeding. In August 2006, the Ninth Circuit upheld October 2, 2000 as the refund effective date for the FPA section 206 refund proceeding, but remanded to the FERC its decision not to consider an FPA section 309 remedy for tariff violations prior to that date. Petitions for rehearing were denied in April 2009. In July 2009, Avista Energy and Avista Utilities filed a motion at the FERC, asking that the companies be dismissed from any further proceedings arising under section 309 pursuant to the remand. The filing pointed out that section 309 relief is based on tariff violations of the seller, and as to Avista Energy and Avista Utilities, these allegations had already been fully adjudicated in the proceeding that gave rise to the Agreement in Resolution, discussed above. There, the FERC absolved both companies of all allegations of market manipulation or wrongdoing that would justify or permit FPA sections 206 or 309 remedies during 2000 and 2001.

Any potential liabilities or refunds owed by or to Avista Energy in the California refund proceeding were retained by Avista Corp. and/or its subsidiaries and have not been transferred to Shell Energy and/or its affiliates based upon the 2007 sales agreement.

Because the resolution of the California refund proceeding remains uncertain, legal counsel cannot express an opinion on the extent of the Company s liability, if any. However, based on information currently known, the Company does not expect that the refunds ultimately ordered for the Refund Period will have a material adverse effect on its financial condition, results of operations or cash flows. This is primarily due to the fact that the FERC orders have stated that any refunds will be netted against unpaid amounts owed to the respective parties and the Company does not believe that refunds would exceed unpaid amounts owed to the Company.

Pacific Northwest Refund Proceeding

In July 2001, the FERC initiated a preliminary evidentiary hearing to develop a factual record as to whether prices for spot market sales of wholesale energy in the Pacific Northwest between December 25, 2000, and June 20, 2001, were just and reasonable. In June 2003, the FERC terminated the Pacific Northwest refund proceedings, after finding that the equities do not justify the imposition of refunds. In August 2007, the Ninth Circuit found that the FERC, in denying the request for refunds, had failed to take into account new evidence of market manipulation in the California energy market and its potential ties to the Pacific Northwest energy market and that such failure was arbitrary and capricious and, accordingly, remanded the case to the FERC, stating that the FERC s findings must be

AVISTA CORPORATION

reevaluated in light of the evidence. In addition, the Ninth Circuit concluded that the FERC abused its discretion in denying potential relief for transactions involving energy that was purchased by the California Department of Water Resources (CERS) in the Pacific Northwest and ultimately consumed in California. The Ninth Circuit expressly declined to direct the FERC to grant refunds. Requests for rehearing were denied in April 2009.

In May 2009, the Attorney General of the State of California (California AG) filed a complaint against both Avista Energy and Avista Utilities seeking refunds on sales made to CERS during the period January 18, 2001 to June 20, 2001 under section 309 of the FPA (the Brown Complaint). The sales at issue are limited in scope and are duplicative of claims already at issue in the Pacific Northwest proceeding, discussed above.

Both Avista Utilities and Avista Energy were buyers and sellers of energy in the Pacific Northwest energy market during the period between December 25, 2000, and June 20, 2001, and, if refunds were ordered by the FERC, could be liable to make payments, but also could be entitled to receive refunds from other FERC-jurisdictional entities. The opportunity to make claims against non-jurisdictional entities may be limited based on existing law. The Company cannot predict the outcome of this proceeding or the amount of any refunds that Avista Utilities or Avista Energy could be ordered to make or could be entitled to receive. Therefore, the Company cannot predict the potential impact the outcome of this matter could ultimately have on the Company s results of operations, financial condition or cash flows.

California Attorney General Complaint (the Lockyer Complaint)

In May 2002, the FERC conditionally dismissed a complaint filed in March 2002 by the California AG that alleged violations of the FPA by the FERC and all sellers (including Avista Corp. and its subsidiaries) of electric power and energy into California. The complaint alleged that the FERC s adoption and implementation of market-based rate authority was flawed and, as a result, individual sellers should refund the difference between the rate charged and a just and reasonable rate. In May 2002, the FERC issued an order dismissing the complaint but directing sellers to re-file certain transaction summaries. It was not clear that Avista Corp. and its subsidiaries were subject to this directive but the Company took the conservative approach and re-filed certain transaction summaries in June and July of 2002. In September 2004, the Ninth Circuit upheld the FERC s market-based rate authority, but held that the FERC erred in ruling that it lacked authority to order refunds for violations of its reporting requirement. The Court remanded the case for further proceedings, but did not order any refunds, leaving it to the FERC to consider appropriate remedial options.

In March 2008, the FERC issued an order establishing a trial-type hearing to address whether any individual public utility seller s violation of the Commission s market-based rate quarterly reporting requirement led to an unjust and unreasonable rate for that particular seller in California during the 2000-2001 period. Purchasers in the California markets will be allowed to present evidence that any seller that violated the quarterly reporting requirement failed to disclose an increased market share sufficient to give it the ability to exercise market power and thus cause its market-based rates to be unjust and unreasonable. In particular, the parties are directed to address whether the seller at any point reached a 20 percent generation market share threshold, and if the seller did reach a 20 percent market share, whether other factors were present to indicate that the seller did not have the ability to exercise market power. The California AG, CPUC, PG&E, and SCE filed their testimony in July 2009 and Avista Energy s answering testimony is due in September 2009.

Based on information currently known to the Company s management and the fact that neither Avista Utilities nor Avista Energy ever reached a 20 percent generation market share during 2000 or 2001, the Company does not expect that this matter will have a material adverse effect on its financial condition, results of operations or cash flows.

Colstrip Generating Project Complaints

In March 2007, two families that own property near the holding ponds from Units 3 & 4 of the Colstrip Generating Project (Colstrip) filed a complaint against the owners of Colstrip and Hydrometrics, Inc. in Montana District Court. Avista Corp. owns a 15 percent interest in Units 3 & 4 of Colstrip. The plaintiffs allege that the holding ponds and remediation activities have adversely impacted their property. They allege contamination, decrease in water tables, reduced flow of streams on their property and other similar impacts to their property. They also seek punitive damages, attorney s fees an order by the court to remove certain ponds, and the forfeiture of profits earned from the generation of Colstrip. The trial is set to begin in May 2011. Because the resolution of this complaint remains uncertain, legal counsel cannot express an

opinion on the extent, if any, of the Company s liability. However, based on information currently known to the Company s management, the Company does not expect this complaint will have a material adverse effect on its financial condition, results of operations or cash flows.

Table of Contents

AVISTA CORPORATION

Colstrip Royalty Claim

Western Energy Company (WECO) supplies coal to the owners of Units 3 & 4 of Colstrip under a Coal Supply Agreement and a Transportation Agreement. The Minerals Management Service (MMS) of the United States Department of the Interior has issued orders, going back to 1991, to WECO to pay additional royalties concerning coal delivered to Units 3 & 4 of Colstrip via the conveyor belt. The owners of Units 3 & 4 of Colstrip take delivery of the coal at the beginning of the conveyor belt.

The orders assert that additional royalties are owed to MMS as a result of WECO not paying royalties in connection with revenue received by WECO from the owners of Units 3 & 4 of Colstrip under the Transportation Agreement during the period October 1, 1991 through December 31, 2007.

The state of Montana also filed claims assessing additional coal production taxes on Coal Transportation Agreement revenues collected by WECO from the owners of Units 3 & 4 of Colstrip. Settlement of production tax claims has recently occurred between WECO and the Montana Department of Revenue.

WECO and the owners of Units 3 & 4 of Colstrip have agreed to a cost sharing agreement for the payment of the settlements owed to the Montana Department of Revenue for coal production taxes and for the MMS royalty claim. Avista Corp s share of the settlements, going back to 1991, for both claims for royalties, taxes and interest claimed was $1.8 million including payments for the calendar year 2008.

The Company expects to recover, through the ratemaking process, the amounts paid and included in fuel costs through the ERM and PCA mechanism.

Harbor Oil Inc. Site

Avista Corp. used Harbor Oil Inc. (Harbor Oil) for the recycling of waste oil and non-PCB transformer oil in the late 1980s and early 1990s. In June 2005, the Environmental Protection Agency (EPA) Region 10 provided notification to Avista Corp. and several other parties, as customers of Harbor Oil, that the EPA had determined that hazardous substances were released at the Harbor Oil site in Portland, Oregon and that Avista Corp. and several other parties may be liable for investigation and cleanup of the site under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly referred to as the federal Superfund law, which provides for joint and several liability. The initial indication from the EPA is that the site may be contaminated with PCBs, petroleum hydrocarbons, chlorinated solvents and heavy metals. Six potentially responsible parties, including Avista Corp., signed an Administrative Order on Consent with the EPA on May 31, 2007 to conduct a remedial investigation and feasibility study (RI/FS). The total cost of the RI/FS is estimated to be $1.2 million and will take approximately 2 1/2 years to complete. The actual cleanup, if any, will not occur until the RI/FS is complete. Based on the review of its records related to Harbor Oil, the Company does not believe it is a major contributor to this potential environmental contamination based on the de minimus volume of waste oil it delivered to the Harbor Oil site. However, there is currently not enough information to allow the Company to assess the probability or amount of a liability, if any, being incurred. As such, it is not possible to make an estimate of any liability at this time.

Lake Coeur d Alene

In July 1998, the United States District Court for the District of Idaho issued its finding that the Coeur d Alene Tribe (the Tribe) owns, among other things, portions of the bed and banks of Lake Coeur d Alene (Lake) lying within the current boundaries of the Tribe s reservation lands. The United States District Court decision was affirmed by the United States Court of Appeals for the Ninth Circuit and the United States Supreme Court in June 2001. This ownership decision resulted in, among other things, Avista Corp. being liable to the Tribe for water storage on the Tribe s land and for Section 10(e) payments.

The Company s Post Falls Hydroelectric Generating Station (Post Falls) controls the water level in the Lake for portions of the year (including portions of the lakebed owned by the Tribe).

In December 2008, Avista Corp., the Tribe and the United States Department of Interior (DOI) finalized an agreement regarding a range of issues related to Post Falls and the Lake. The agreement establishes the amount of past and future compensation Avista Corp. will pay for the use of the Tribe s reservation lands under Section 10(e) of the Federal Power Act (Section 10(e) payments) and issues related to relicensing of the Company s hydroelectric generating facilities located on the Spokane River (see Spokane River Relicensing below).

Table of Contents

AVISTA CORPORATION

Avista Corp. agreed to compensate the Tribe a total of $39 million ($25 million paid in 2008, $10 million to be paid in 2009 and $4 million to be paid in 2010) for trespass and Section 10(e) payments for past storage of water for the period from 1907 through 2007. Avista Corp. agreed to compensate the Tribe for future storage of water through Section 10(e) payments of $0.4 million per year beginning in 2008 and continuing through the first 20 years of the new license and $0.7 million per year through the remaining term of the license.

In addition to Section 10(e) payments, Avista Corp. agreed to make annual payments over the life of the new FERC license to fund a variety of protection, mitigation and enhancement measures on the Coeur d Alene Reservation required under Section 4(e) of the Federal Power Act. These payments involve creation of a Coeur d Alene resource protection trust fund (the Trust Fund). Annual payments from the Company to the Trust Fund for protection, mitigation and enhancement measurements commenced with the issuance of the new FERC license issued in June 2009 and are expected to total approximately $100 million over an assumed 50-year license term (the 2010 payment of $12.0 million was paid in July 2009).

In September 2008, as part of the settlement of the Company s general rate case, the IPUC approved deferral of the Idaho jurisdictional allocation of amounts paid to the Tribe, the Trust Fund or related to the licensing of its hydroelectric generating facilities for later recovery through rates in a subsequent general rate filing. In June 2009, Avista Corp. entered into an all-party settlement stipulation with respect to its general rate case that was filed with the IPUC in January 2009. This settlement stipulation, which included the recovery of amounts paid to the Tribe, the Trust Fund or related to the licensing of Avista Corp. s hydroelectric generating facilities, was approved by the IPUC in July 2009.

In December 2008, as part of the settlement of the Company s general rate case, the WUTC approved deferral of the Washington jurisdictional allocation of amounts paid to the Tribe, the Trust Fund or related to the licensing of its hydroelectric generating facilities for later recovery through rates in a subsequent general rate filing.

On January 27, 2009, the Public Counsel Section of the Washington Attorney General s Office (Public Counsel) filed a Petition for Judicial Review of the WUTC s December 2008 order approving the settlement of the Company s general rate case. Public Counsel raised a number of issues that were previously argued before the WUTC. These include whether settlement costs associated with resolving the dispute with the Tribe were prudent and whether recovery of such costs would constitute illegal retroactive ratemaking. The appeals process may take several months and a decision is not expected until later in 2009 or early 2010. The court will either affirm the decision of the WUTC in its entirety or reverse the decision, in whole or in part, and possibly remand the matter back to the WUTC for further consideration, which could possibly result in small refunds to customers and regulatory disallowance of the Washington portion, approximately $25.2 million, that the Company has agreed to compensate the Tribe. The Company cannot predict the potential impact the outcome of this matter could ultimately have on the Company s results of operations, financial condition or cash flows.

Spokane River Relicensing

The Company owns and operates six hydroelectric plants on the Spokane River, and five of these (Long Lake, Nine Mile, Upper Falls, Monroe Street, and Post Falls, which have a total present capability of 144.1 MW) are under one FERC license and are referred to as the Spokane River Project. The sixth, Little Falls, is operated under separate Congressional authority and is not licensed by the FERC.

The Company filed a Notice of Intent to Relicense in July 2002. The formal consultation process involving planning and information gathering with stakeholder groups lasted through July 2005, when the Company filed its new license applications with the FERC. Since 2005 the Company has been involved in various legal proceedings as well as settlement discussions to resolve issues related to Spokane River Project operations and resource impacts associated with the Spokane River Project. After completion of formal proceedings, and subsequent to the resolution of known issues, FERC issued a new single 50-year license for the Spokane River Project on June 18, 2009.

The new license incorporated the 4(e) conditions that were included in the December 2008 Settlement Agreement with the Department of Interior and the Coeur d Alene Tribe, as well as the mandatory conditions that were agreed to in the Idaho 401 Water Quality Certifications and in the amended Washington 401 Water Quality Certification. Various issues that were appealed under the Washington 401 Water Quality Certification were subsequently resolved through settlement.

AVISTA CORPORATION

The Company s estimate of the potential cost of the conditions proposed for the Spokane River Project, based on estimates of what it would cost to implement the recommendations and conditions included in the FERC s FEIS and the numerous settlement agreements, total approximately $305 million over a 50-year period.

In addition, the December 2008 Settlement Agreement between the Company and the Tribe resolved FPA Section 10(e), or water storage payments related to the Post Falls hydroelectric facility. Under the Agreement, Avista Corp. will pay the Tribe $0.4 million annually for the first 20 years of a new FERC license and $0.7 million annually for the remainder of the license term for Section 10(e) charges.

The WUTC approved, for future recovery, costs incurred in relicensing the Spokane River Project, as well as the costs related to settlement with the Tribe. The Public Counsel Section of the Washington Attorney General s Office filed a Petition for Judicial Review of the WUTC s December 2008 order approving the settlement of the Company s Washington general rate case, which included the costs related to settlement with the Tribe. Refer to the Lake Coeur d Alene disclosure included in note 11 above for further details. The WUTC approved deferred accounting treatment, with a carrying cost, until these costs are reflected in future retail rates. The IPUC approved similar deferred accounting treatment. The Company s general rate cases, filed in January 2009, reflect recovery of both the direct and deferred costs. The Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to the relicensing of the Spokane River Project.

Clark Fork Settlement Agreement

Dissolved atmospheric gas levels exceed state of Idaho and federal water quality standards downstream of the Cabinet Gorge Hydroelectric Generating Project (Cabinet Gorge) during periods when excess river flows must be diverted over the spillway. Under the terms of the Clark Fork Settlement Agreement, the Company developed an abatement and mitigation strategy with the other signatories to the Agreement and developed the Gas Supersaturation Control Program (GSCP). The Idaho Department of Environmental Quality and the United States Fish and Wildlife Service (USFWS) approved the GSCP in February 2004 and the FERC issued an order approving the GSCP in January 2005.

The GSCP provides for the opening and modification of one and, potentially, both of the two existing diversion tunnels built when Cabinet Gorge was originally constructed. When river flows exceed the capacity of the powerhouse turbines, the excess flows would be diverted to the tunnels rather than released over the spillway. The Company has undertaken physical and computer modeling studies to confirm the feasibility and likely effectiveness of the tunnel solution. Analysis of the predicted total dissolved gas performance indicates that the tunnels will not meet the performance criteria anticipated in the GSCP. In August 2007, the Gas Supersaturation Subcommittee concluded that the tunnel project does not meet the expectations of the GSCP and is not an acceptable project. As a result, the Company has met and will continue meeting with key stakeholders to review and amend the GSCP which includes developing alternatives to the construction of the tunnels. The Company has expended $5.1 million on the tunnel project. The WUTC and IPUC have accepted the recovery of these costs through rates.

The USFWS has listed bull trout as threatened under the Endangered Species Act. The Clark Fork Settlement Agreement describes programs intended to restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, the Company is evaluating the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies will help the Company and other parties determine the best use of funds toward continuing fish passage efforts or other bull trout population enhancement measures.

Air Quality

The Company must be in compliance with requirements under the Clean Air Act and Clean Air Act Amendments for its thermal generating plants. The Company continues to monitor legislative developments at both the state and national level for the potential of further restrictions on sulfur dioxide, nitrogen oxide and carbon dioxide, as well as other greenhouse gas and mercury emissions.

In 2006, the Montana Department of Environmental Quality (Montana DEQ) adopted final rules for the control of mercury emissions from coal-fired plants. The new rules set strict mercury emission limits by 2010, and put in place a recurring ten-year review process to ensure facilities are keeping pace with advancing technology in mercury emission control. The rules also provide for temporary alternate emission limits provided certain provisions are met, and they allocate mercury emission credits in a manner that rewards the cleanest facilities.

29

AVISTA CORPORATION

Compliance with new and proposed requirements and possible additional legislation or regulations will result in increases to capital expenditures and operating expenses for expanded emission controls at the Company s thermal generating facilities. The Company, along with the other owners of Colstrip, completed the first phase of testing on two mercury control technologies. The joint owners of Colstrip believe based upon preliminary results that the plant will be able to comply with the Montana law without utilizing the temporary alternate emission limit provision. Preliminary estimates indicate that the Company s share of installation capital costs will be $1.5 million and annual operating costs will increase by $1.5 million (beginning in late-2009). The Company will continue to seek recovery, through the ratemaking process, of the costs to comply with various air quality requirements.

Residential Exchange Program

The residential exchange program is intended to provide access to the benefits of low-cost federal hydroelectric power to residential and small-farm customers of the region s private (investor owned) and public (governmental or customer owned) utilities. The Bonneville Power Administration (BPA) administers the residential exchange program under the Northwest Power Act. Avista Corp. customers are currently receiving benefits under a new Residential Exchange Contract signed with the BPA for 2009 through 2011. Under this contract, residential exchange benefits for Avista Corp. customers were expected to be $2.4 million for the period November 1, 2008 through October 31, 2009. The substantial reduction in benefits from the previous year was primarily due to the BPA s calculation of benefits in connection with a disputed provision in Avista s 1981 Residential Exchange Contract. Avista Corp. and the BPA recently announced a settlement and resolution of the disputed Residential Exchange Contract issue. The settlement results in a benefit to Avista Corp. customers for the period November 1, 2008 through October 31, 2009 of $8.9 million. The WUTC and IPUC approved Avista Corp. s filings to increase customer bill credits effective August 1, 2009. The amount of the bill credit is calculated to reflect the disbursement of $8.9 million for the period October 1, 2008 through September 30, 2009, and an expected $6.3 million for the period October 1, 2009 through September 30, 2010. Petitions for review are currently pending in the United States Court of Appeals for the Ninth Circuit which challenge certain terms of the Residential Exchange Contracts as well as the BPA s final record of decision, which establishes the methodology and rates that determine the residential exchange benefits for Avista s customers.

Since the residential exchange payments are passed through to Avista Corp. s residential and small farm customers as adjustments to electric bills, Avista Corp. does not expect the payments or any pending litigation regarding the residential exchange program benefits for Avista Corp. s customers to impact Avista Corp. s net income.

Noxon Rapids Hydroelectric Facility

In late February 2009, a spill of mineral oil occurred at the Company s Noxon Rapids Hydroelectric Generating Project (Noxon Rapids) located near Noxon, Montana. Operators at Noxon Rapids discovered ice that had built up on the face of the dam fell off and broke a pressure gauge on the valve of a pipe carrying oil, causing the oil to spill onto the transformer deck. The deck contains storm water drains and just over 1,000 gallons of lightweight mineral oil was released from one of these drains into the stretch of the Clark Fork River between the Noxon Rapids and Cabinet Gorge hydroelectric projects (the Company owns and operates both projects). The Company completed cleanup immediately and further follow up in April 2009 pursuant to an Agreed Order issued by the EPA. The Company completed the terms of the Agreed Order issued by the EPA in April 2009. The Company accrued $1.5 million related to the estimated cleanup costs during 2009. The Company s estimate of its liability could change in future periods due to possible penalties. The Company cannot predict the potential impact the outcome of this matter could ultimately have on the Company s results of operations, financial condition or cash flows.

Other Contingencies

In the normal course of business, the Company has various other legal claims and contingent matters outstanding. The Company believes that any ultimate liability arising from these actions will not have a material adverse impact on its financial condition, results of operations or cash flows. It is possible that a change could occur in the Company s estimates of the probability or amount of a liability being incurred. Such a change, should it occur, could be significant.

NOTE 12. POTENTIAL HOLDING COMPANY FORMATION

At the Annual Meeting of Shareholders in May 2006, the shareholders of Avista Corp. approved a proposal to proceed with a statutory share exchange, which would change the Company s organization to a holding company structure. The holding company, currently named AVA Formation Corp. (AVA), would become the parent of Avista Corp. After the contemplated dividend to AVA of the capital stock of Avista Capital (Avista Capital Dividend) now held by Avista Corp., AVA would then also be the parent of Avista Capital. The Avista Capital Dividend would effect the structural separation of Avista Corp. s non-utility businesses from its regulated utility business.

AVISTA CORPORATION

Avista Corp. received approval from the FERC in April 2006 (conditioned on approval by the state regulatory agencies), the IPUC in June 2006 and the WUTC in February 2007. Avista Corp. also filed for approval from the utility regulators in Oregon and Montana and proceedings are pending in each of these jurisdictions. The statutory share exchange is subject to the receipt of the remaining regulatory approvals and the satisfaction of other conditions. The Company cannot predict when the regulatory decisions will be obtained or if they will be on terms acceptable to the Company.

The IPUC accepted a stipulation entered into between Avista Corp. and the IPUC Staff that sets forth a variety of conditions, which would serve to segregate the Company s utility operations from the other businesses conducted by the holding company. The stipulation among other things would require Avista Corp. to maintain certain common equity levels as part of its capital structure. The calculation of the utility equity component is essentially the ratio of Avista Corp. s total common equity to total capitalization excluding, in each case, Avista Corp. s investment in Avista Capital. The utility equity component was approximately 45.7 percent as of June 30 2009. In addition, IPUC approval would be required for any dividend from Avista Corp. to the holding company that would reduce utility common equity below 25 percent of total capitalization which, for this purpose, includes long and short-term debt, capitalized lease obligations and preferred and common equity.

The WUTC accepted a similar stipulation entered into between Avista Corp. and the WUTC staff. WUTC approval would be required for any dividend from Avista Corp. to the holding company that would reduce utility common equity below 30 percent of total capitalization.

Pursuant to the Plan of Share Exchange, a statutory share exchange would be effected whereby each outstanding share of Avista Corp. common stock would be exchanged for one share of AVA common stock, no par value, so that holders of Avista Corp. common stock would become holders of AVA common stock and Avista Corp. would become a subsidiary of AVA. The other outstanding securities of Avista Corp. would not be affected by the statutory share exchange, with limited exceptions for stock options and other securities outstanding under equity compensation and employee benefit plans.

NOTE 13. INFORMATION BY BUSINESS SEGMENTS

The business segment presentation reflects the basis used by the Company s management to analyze performance and determine the allocation of resources. Avista Utilities business is managed based on the total regulated utility operation. Advantage IQ is a provider of facility information and cost management services for multi-site customers throughout North America. The Other category, which is not a reportable segment, includes the remaining activities of Avista Energy, other investments and operations of various subsidiaries, as well as certain other operations of Avista Capital.

The following table presents information for each of the Company s business segments (dollars in thousands):

	Avista Utilities	Advantage IQ	Other	Total Non-Utility	Intersegment Eliminations (1)	Total
For the three months ended June 30, 2009:						
Operating revenues	$ 279,865	$ 18,046	$ 9,200	$ 27,246	$	$ 307,111
Resource costs	125,651		5,341	5,341		130,992
Other operating expenses	57,489	14,241	4,275	18,516		76,005
Depreciation and amortization	23,180	1,041	329	1,370		24,550
Income (loss) from operations	56,063	2,764	(745)	2,019		58,082
Interest expense (2)	16,374	20	59	79	(40)	16,413
Income taxes	14,948	997	(326)	671		15,619
Net income (loss) attributable to Avista Corporation	25,381	1,276	(805)	471		25,852
Capital expenditures	46,390	650	2	652		47,042
For the three months ended June 30, 2008:						
Operating revenues	$ 326,645	$ 12,401	$ 11,264	$ 23,665	$	$ 350,310
Resource costs	183,075		5,535	5,535		188,610

Other operating expenses	52,520	9,199	5,301	14,500		67,020
Depreciation and amortization	21,914	639	414	1,053		22,967
Income from operations	53,913	2,563	14	2,577		56,490
Interest expense (2)	22,204	35	47	82	(16)	22,270
Income taxes	12,393	946	(34)	912		13,305
Net income (loss) attributable to Avista Corporation	22,026	1,579	(60)	1,519		23,545
Capital expenditures	43,102	868	82	950		44,052

Table of Contents

AVISTA CORPORATION

	Avista Utilities	Advantage IQ	Other	Total Non-Utility	Intersegment Eliminations (1)	Total
For the six months ended June 30, 2009:						
Operating revenues	$ 740,730	$ 35,386	$ 18,465	$ 53,851	$	$ 794,581
Resource costs	415,343		11,068	11,068		426,411
Other operating expenses	115,222	27,931	7,878	35,809		151,031
Depreciation and amortization	46,103	2,067	665	2,732		48,835
Income (loss) from operations	119,685	5,388	(1,146)	4,242		123,927
Interest expense (2)	33,222	137	73	210	(73)	33,359
Income taxes	31,949	1,876	(738)	1,138		33,087
Net income (loss) attributable to Avista Corporation	55,964	2,442	(1,527)	915		56,879
Capital expenditures	87,900	1,632	8	1,640		89,540
For the six months ended June 30, 2008:						
Operating revenues	$ 798,917	$ 24,921	$ 22,779	$ 47,700	$	$ 846,617
Resource costs	501,301		11,455	11,455		512,756
Other operating expenses	104,239	18,090	10,255	28,345		132,584
Depreciation and amortization	43,356	1,263	799	2,062		45,418
Income from operations	109,713	5,568	270	5,838		115,551
Interest expense (2)	42,772	55	98	153	(30)	42,895
Income taxes	26,380	2,063	(49)	2,014		28,394
Net income attributable to Avista Corporation	45,340	3,345	91	3,436		48,776
Capital expenditures	90,782	1,954	95	2,049		92,831
Total Assets:						
As of June 30, 2009	$ 3,302,162	$ 130,319	$ 65,361	$ 195,680	$	$ 3,497,842
As of December 31, 2008	3,434,844	125,911	69,992	195,903		3,630,747

(1) Intersegment eliminations reported as interest expense represent intercompany interest.
(2) Including interest expense to affiliated trusts.

32

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Avista Corporation

Spokane, Washington

We have reviewed the accompanying condensed consolidated balance sheet of Avista Corporation and subsidiaries (the Corporation) as of June 30, 2009, and the related condensed consolidated statements of income and of comprehensive income for the three-month and six-month periods ended June 30, 2009 and 2008, and of stockholders equity and cash flows for the six-month periods ended June 30, 2009 and 2008. These interim financial statements are the responsibility of the Corporation s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Avista Corporation and subsidiaries as of December 31, 2008, and the related consolidated statements of income, comprehensive income, stockholders equity, and cash flows for the year then ended prior to retrospective adjustment for the adoption of Financial Accounting Standards Board Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (not presented herein); and in our report dated February 27, 2009, we expressed an unqualified opinion on those consolidated financial statements. We also audited the adjustments described in Note 2 that were applied to retrospectively adjust the December 31, 2008 consolidated balance sheet of Avista Corporation and subsidiaries (not presented herein). In our opinion, such adjustments are appropriate and have been properly applied to the previously issued consolidated balance sheet in deriving the accompanying retrospectively adjusted condensed consolidated balance sheet as of December 31, 2008.

/s/ Deloitte & Touche LLP

Seattle, Washington

August 7, 2009

Table of Contents

AVISTA CORPORATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

From time to time, we make forward-looking statements such as statements regarding projected or future:

financial performance,

capital expenditures,

dividends,

capital structure,

other financial items,

strategic goals and objectives, and

plans for operations.

These statements have underlying assumptions (many of which are based, in turn, upon further assumptions). Such statements are made both in our reports filed under the Securities Exchange Act of 1934, as amended (including this Quarterly Report on Form 10-Q), and elsewhere. Forward-looking statements are all statements except those of historical fact including, without limitation, those that are identified by the use of words that include will, may, could, should, intends, plans, seeks, anticipates, estimates, expects, forecasts, projects, p expressions.

Forward-looking statements (including those made in this Quarterly Report on Form 10-Q) are subject to a variety of risks and uncertainties and other factors. Most of these factors are beyond our control and many of them could have a significant effect on our operations, results of operations, financial condition or cash flows. This could cause actual results to differ materially from those anticipated in our statements. Such risks, uncertainties and other factors include, among others:

weather conditions and its effect on energy demand and generation, including the effect of precipitation and temperatures on the availability of hydroelectric resources and the effect of temperatures on customer demand and wholesale energy markets;

global financial and economic conditions (including the availability of credit) and their effect on our ability to obtain funding for working capital and long-term capital requirements on acceptable terms;

economic conditions in our service areas, including the effect on the demand for, and customers ability to pay for, our utility services;

our ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including our credit ratings, interest rates and other capital market conditions;

changes in actuarial assumptions, the interest rate environment and the actual return on plan assets for our pension plan, which can affect future funding obligations, costs and pension plan liabilities;

changes in wholesale energy prices that can affect, among other things, the cash requirements to purchase electricity and natural gas for retail customers or wholesale obligations and the market value of derivative assets and liabilities;

volatility and illiquidity in wholesale energy markets, including the availability of willing buyers and sellers, and prices of purchased energy and demand for energy sales;

the effect of state and federal regulatory decisions affecting our ability to recover costs and/or earn a reasonable return including, but not limited to, the disallowance of costs and investments, and delay in the recovery of ownership and operating costs;

the potential effects of legislation or administrative rulemaking, including the possible adoption of national or state laws requiring resources to meet certain standards and placing restrictions on greenhouse gas emissions to mitigate concerns over global climate changes;

the outcome of pending regulatory and legal proceedings arising out of the western energy crisis of 2000 and 2001, and including possible retroactive price caps and resulting refunds;

the outcome of legal proceedings and other contingencies;

changes in, and compliance with, environmental and endangered species laws, regulations, decisions and policies, including present and potential environmental remediation costs;

wholesale and retail competition including, but not limited to, electric retail wheeling and transmission costs;

the ability to maintain licenses for our hydroelectric generating facilities at cost-effective levels with reasonable terms and conditions;

unplanned outages at any of our generating facilities or the inability of facilities to operate as intended;

unanticipated delays or changes in construction costs, as well as our ability to obtain required operating permits for present or prospective facilities;

Table of Contents

AVISTA CORPORATION

natural disasters that can disrupt energy production or delivery, as well as the availability and costs of materials and supplies and support services;

blackouts or disruptions of interconnected transmission systems;

the potential for terrorist attacks or other malicious acts, particularly with respect to our utility assets;

changes in the long-term climate of the Pacific Northwest, which can affect, among other things, customer demand patterns and the volume and timing of streamflows to our hydroelectric resources;

changes in industrial, commercial and residential growth and demographic patterns in our service territory;

the loss of significant customers and/or suppliers;

default or nonperformance on the part of any parties from which we purchase and/or sell capacity or energy;

deterioration in the creditworthiness of our customers and counterparties;

the effect of any potential decline in our credit ratings;

increasing health care costs and the resulting effect on health insurance provided to our employees and retirees;

increasing costs of insurance, changes in coverage terms and our ability to obtain insurance;

employee issues, including changes in collective bargaining unit agreements, strikes, work stoppages or the loss of key executives, as well as our ability to recruit and retain employees;

the potential effects of negative publicity regarding business practices, whether true or not, which could result in, among other things, costly litigation and a decline in our common stock price;

changes in technologies, possibly making some of the current technology obsolete;

changes in tax rates and/or policies; and

changes in our strategic business plans, which may be affected by any or all of the foregoing, including the entry into new businesses and/or the exit from existing businesses.

Our expectations, beliefs and projections are expressed in good faith. We believe they are reasonable based on, without limitation, an examination of historical operating trends, data contained in our records and other data available from third parties. However, there can be no assurance that our expectations, beliefs or projections will be achieved or accomplished. Furthermore, any forward-looking statement speaks only as of the date on which such statement is made. We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances that occur after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of such factors, nor can we assess the effect of each such factor on our business or the extent to which any such factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

In this Form 10-Q, we discuss our credit ratings. It is important to note that these credit ratings are not recommendations to buy, sell or hold securities. The ratings are subject to change or withdrawal at any time by the respective credit rating agencies. Each credit rating should be evaluated independently of any other ratings.

The following discussion and analysis is provided for the consolidated financial condition and results of operations of Avista Corp. and its subsidiaries. This discussion focuses on significant factors concerning our financial condition and results of operations and should be read along with the condensed consolidated financial statements.

Potential Holding Company Formation

At the Annual Meeting of Shareholders in May 2006, the shareholders of Avista Corp. approved a proposal to proceed with a statutory share exchange, which would change our organization to a holding company structure. We received approval from the FERC in April 2006 (conditioned on approval by the state regulatory agencies), the IPUC in June 2006 and the WUTC in February 2007. We also filed for approval from the utility regulators in Oregon and Montana and proceedings are pending in each of these jurisdictions. The statutory share exchange is subject to the receipt of the remaining regulatory approvals and the satisfaction of other conditions. We can not predict when regulatory decisions will be obtained or if they will be on terms acceptable to us. See further information at Note 12 of the Notes to Condensed Consolidated Financial Statements.

Business Segments

We have two reportable business segments as follows:

Avista Utilities an operating division of Avista Corp. comprising our regulated utility operations. Avista Utilities generates, transmits and distributes electricity and distributes natural gas. The utility also engages in wholesale purchases and sales of electricity and natural gas.

35

AVISTA CORPORATION

Advantage IQ an indirect subsidiary of Avista Corp. (approximately 76 percent owned as of June 30, 2009) that provides sustainable utility expense management solutions, partnering with multi-site companies across North America to assess and manage utility costs and usage. Advantage IQ s primary product lines include processing, payment and auditing of energy, telecom, waste, water/sewer and lease bills as well as strategic management services.

We have other businesses, including sheet metal fabrication, venture fund investments and real estate investments, as well as certain natural gas storage facilities and a power purchase agreement held by Avista Energy.. These activities do not represent a reportable segment.

Advantage IQ, Avista Energy, and various other companies are subsidiaries of Avista Capital, Inc. (Avista Capital) which is a direct, wholly owned subsidiary of Avista Corp. Our total Avista Corporation stockholders equity was $1,033.0 million as of June 30, 2009, of which $77.5 million represented our investment in Avista Capital.

The following table presents net income (loss) for each of our business segments (and the other businesses) for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Avista Utilities	$ 25,381	$ 22,026	$ 55,964	$ 45,340
Advantage IQ	1,276	1,579	2,442	3,345
Other	(805)	(60)	(1,527)	91
Net income attributable to Avista Corporation	$ 25,852	$ 23,545	$ 56,879	$ 48,776

Executive Level Summary

Overall

Our operating results and cash flows are primarily from:

- regulated utility operations (Avista Utilities), and
- facility information and cost management services for multi-site customers (Advantage IQ).

Our net income was $25.9 million for the three months ended June 30, 2009, an increase from $23.5 million for the three months ended June 30, 2008. This increase was primarily due to increased earnings at Avista Utilities (primarily due to the implementation of general rate increases in Washington and Idaho) as well as a decrease in interest expense. Our net income was $56.9 million for the six months ended June 30, 2009, an increase from $48.8 million for the six months ended June 30, 2008. Consistent with the quarterly increase, this was primarily due to increased earnings at Avista Utilities as well as a decrease in interest expense.

In late 2007, early 2008, and early 2009, respectively Moody s Investors Service, Standard & Poor s and Fitch Ratings upgraded our credit ratings, which resulted in an investment grade rating for our senior unsecured debt and corporate rating from each of these rating agencies. The upgrades reflected several steps taken over the past few years to lower our business risk profile and improve financial metrics.

It is important to note that we are at the lower end of the investment grade category. We are working to continuously strengthen our credit ratings by improving earnings and operating cash flows, controlling costs and reducing our debt ratio.

Our operations are affected by global financial and economic conditions. The instability within the financial markets has caused industry-wide concern regarding the ability to access sufficient capital at a reasonable cost. The turmoil has also resulted in significant declines in the market values of assets held by pension plans (which may continue to impact the funded status of pension plans) as well as concerns regarding credit risk.

We are observing declines in employment throughout our service area due to cutbacks in the construction, forest products, mining and manufacturing sectors. Non-farm employment contraction for June 2009 as compared to June 2008 was 4.3 percent in Spokane, Washington, 3.9 percent in Medford, Oregon and 2.6 percent in Coeur d Alene, Idaho, compared to the national average decline of 4.2 percent. Unemployment rates are much higher than a year ago in our eastern Washington, northern Idaho and southern Oregon service areas. Unemployment rates for June 2009 were 8.9 percent in Spokane, Washington, 8.6 percent in Coeur d Alene, Idaho and 13.6 percent in Medford, Oregon, compared to the national average of 9.5 percent. The housing market in Coeur d Alene, Idaho and Medford, Oregon has continued to deteriorate; the June 2009 monthly foreclosure rate was 0.39 percent in

Table of Contents

AVISTA CORPORATION

Kootenai County (the county that includes Coeur d Alene, Idaho), and 0.30 percent in Jackson County (the county that includes Medford, Oregon) compared to the national foreclosure rate of 0.25 percent; the housing market in Spokane County remains stable with a foreclosure rate of 0.02 percent.

Avista Utilities

Avista Utilities is our most significant business segment. Our utility operating and financial performance is dependent upon, among other things:

- weather conditions,
- the price of natural gas in the wholesale market, including the effect on the price of fuel for generation,
- the price of electricity in the wholesale market, including the effects of weather conditions, natural gas prices and other factors affecting supply and demand,
- regulatory decisions, allowing our utility to recover costs, including purchased power and fuel costs, on a timely basis, and to earn a fair return on investment, and
- the ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including our credit ratings, interest rates and other capital market conditions.

Our utility net income was $25.4 million for the three months ended June 30, 2009, an increase from $22.0 million for the three months ended June 30, 2008 primarily due to an increase in gross margin (operating revenues less resource costs). The increase in gross margin was primarily due to the implementation of the general rate increases in Washington and Idaho effective January 1, 2009 and October 1, 2008, respectively. We recognized an expense of $6.8 million under the ERM for the second quarter of 2009 compared to $4.0 million in the second quarter of 2008. The increase in net income was also partially due to a decrease in interest expense. This was partially offset by an increase in other operating expenses.

Our utility net income was $56.0 million for the six months ended June 30, 2009, an increase from $45.3 million for the six months ended June 30, 2008 primarily due to an increase in gross margin (operating revenues less resource costs). Consistent with the quarterly change, the increase in gross margin was primarily due to the implementation of the general rate increases in Washington and Idaho. We recognized an expense of $4.1 million under the ERM for the six months ended June 30, 2009 compared to $7.4 million for the six months ended June 30, 2008. The increase in net income was also partially due to a decrease in interest expense. This was partially offset by an increase in other operating expenses.

We plan to continue to invest in generation, transmission and distribution systems with a focus on providing reliable service to our customers. Utility capital expenditures were $87.9 million for the six months ended June 30, 2009. We expect utility capital expenditures to be over $210 million for 2009. Actual capital expenditures may vary from our estimates due to factors such as changes in business conditions, construction schedules and environmental requirements.

Advantage IQ

Advantage IQ s net income attributable to Avista Corporation was $1.3 million for the three months ended June 30, 2009, a decrease from $1.6 million for the three months ended June 30, 2008. Advantage IQ s net income attributable to Avista Corporation was $2.4 million for the six months ended June 30, 2009, a decrease from $3.3 million for the six months ended June 30, 2008. The decrease for each period of 2009 as compared to 2008 was primarily due to lower short-term interest rates (which decreases interest revenue), the decrease in our ownership percentage in the business in connection with the acquisition of Cadence Network effective July 2, 2008 and increased amortization of intangible assets (related to the Cadence acquisition refer to the Cadence discussion below). During 2009, we are anticipating slower internal growth at Advantage IQ than had been expected, as some of its clients are experiencing bankruptcies and store closures in these difficult economic times. Additionally, interest revenue is expected to be lower in 2009 due to the historic low short-term interest rate environment that we are currently experiencing, which is expected to continue throughout 2009.

Effective July 2, 2008, Advantage IQ acquired Cadence Network, a Cincinnati-based energy and expense management company. As consideration, the owners of Cadence Network received a 25 percent ownership interest in Advantage IQ. The acquisition of Cadence Network was funded with the issuance of Advantage IQ common stock, which is subject to redemption. Under the transaction agreement, the previous owners of Cadence Network can exercise a right to redeem their shares of Advantage IQ stock during July 2011 or July 2012 if Advantage IQ is not liquidated through either an initial public offering or sale of the business to a third party. Their redemption rights expire July 31, 2012. The redemption price would be determined based on the fair market value of Advantage IQ at the time of the redemption election as determined by certain independent parties.

AVISTA CORPORATION

We would like to monetize at least a portion of our investment in Advantage IQ within the next four years. The potential monetization of Advantage IQ depends on future market conditions, growth of the business and other factors. There can be no assurance that we will be able to complete a monetization event.

Other Businesses

The net loss attributable to Avista Corporation for these operations was $0.8 million for the three months ended June 30, 2009 compared to $0.1 million for the three months ended June 30, 2008. The net loss attributable to Avista Corporation for these operations was $1.5 million for the six months ended June 30, 2009 compared to net income of $0.1 million for the six months ended June 30, 2008. Contributing to the net loss attributable to Avista Corporation in the second quarter and first six months of 2009 were losses on long-term venture fund investments and the accrual of a $0.3 million environmental liability. This environmental liability relates to the final cleanup of a waste water treatment plant site that was decommissioned in 1993.

Liquidity and Capital Resources

We need to access long-term capital markets from time to time to finance capital expenditures, repay maturing long-term debt and obtain additional working capital. Our ability to access capital on reasonable terms is subject to numerous factors, many of which, including market conditions, are beyond our control. Conditions in the financial markets since the fall of 2008 have resulted in companies having limited access to capital on reasonable terms and have resulted in a significant increase in long-term borrowing rates for corporations. If we are unable to obtain capital on reasonable terms, it may limit or prohibit our ability to finance capital expenditures and repay maturing long-term debt. Our liquidity needs could exceed our short-term credit availability and lead to defaults on various financing arrangements. We would also likely be prohibited from paying dividends on our common stock.

We have a committed line of credit in the total amount of $320.0 million with an expiration date of April 5, 2011. We had $260.0 million of cash borrowings and $36.7 million in letters of credit outstanding as of June 30, 2009, under our $320.0 million committed line of credit. In November 2008, we entered into a new committed line of credit in the total amount of $200.0 million with an expiration date of November 24, 2009. We entered into this line of credit to ensure we had adequate liquidity, as conditions in the financial markets resulted in limited access to capital on reasonable terms. To date, we have not borrowed any funds under this committed line of credit.

In March 2009, we amended our accounts receivable sales facility with Bank of America, N.A. to extend the termination date to March 2010. Under this facility, we can sell without recourse, on a revolving basis, up to $85.0 million of accounts receivable. Based upon calculations of our eligible accounts receivable under this agreement, we had the ability to sell up to $56.0 million as of June 30, 2009. There were $14.0 million in accounts receivable sold under this facility as of June 30, 2009.

The Receivables Purchase Agreement requires a receivables report to be prepared on a monthly basis, including information related to customer account delinquency ratios. The June 30, 2009 report indicated that one measurement of the delinquency ratios was in excess of the threshold specified in the Receivables Purchase Agreement, triggering an optional liquidation event. An amendment to the Receivables Purchase Agreement was executed which waived the occurrence of the liquidation event arising from the customer account delinquency ratio increase reflected in the June 30, 2009 report. See further information at Note 3 of the Notes to Condensed Consolidated Financial Statements.

As of June 30, 2009, we had a combined $265.3 million of available liquidity under our $320.0 million committed line of credit, $200.0 million committed line of credit, and $85.0 million revolving accounts receivable sales facility.

On April 1, 2009, we redeemed the total amount outstanding ($61.9 million) of our Junior Subordinated Debt Securities held by AVA Capital Trust III (Long-term Debt to Affiliated Trusts). Concurrently, AVA Capital Trust III redeemed all of the Preferred Trust Securities issued to third parties ($60.0 million) and all of the Common Trust Securities issued to us ($1.9 million). The net redemption of $60.0 million was funded by borrowings under our $320.0 million committed line of credit agreement.

We anticipate issuing long-term debt during 2009 to reduce the balances outstanding under our committed line of credit agreements. We do not have any scheduled long-term debt maturities in 2009. The current portion of long-term debt includes $17 million of Pollution Control Bonds because the bonds are subject to purchase at any time at the option of the bond holder due to the interest rate currently being reset daily.

Table of Contents

AVISTA CORPORATION

After considering the issuances of long-term debt during 2009, we expect net cash flows from operating activities and our committed line of credit agreements (total of $520.0 million) to provide adequate resources to fund:

- capital expenditures,
- dividends, and
- other contractual commitments.

In December 2006, we entered into a sales agency agreement with a sales agent to issue up to 2 million shares of our common stock from time to time. We issued 750,000 shares of common stock under this sales agency agreement in 2008. We will continue to evaluate issuing common stock in future periods; however, we are not currently planning to issue common stock for the remainder of 2009, other than for compensatory plans and the direct stock purchase and dividend reinvestment plan.

Due to market conditions and the decline in the fair value of pension plan assets, we are planning to contribute $48 million to the pension plan in 2009 ($32 million was contributed during the first half of 2009) as compared to the $28 million we contributed in 2008. The final determination of pension plan contributions beyond 2009 is subject to multiple variables, most of which are beyond our control, including further changes to the fair value of pension plan assets and changes in actuarial assumptions (in particular the discount rate used in determining the projected benefit obligation). We have adequate liquidity to meet our pension plan funding obligations for 2009.

Avista Utilities Regulatory Matters

General Rate Cases

We regularly review the need for electric and natural gas rate changes in each state in which we provide service. We will continue to file for rate adjustments to:

- provide for recovery of operating costs and capital investments, and
- more closely align earned returns with those allowed by regulators.

With regards to the timing and plans for future filings, the assessment of our need for rate relief and the development of rate case plans takes into consideration short-term and long-term needs, as well as specific factors that can affect the timing of rate filings. Such factors include in-service dates of major capital investments and the timing of changes in major revenue and expense items. Primarily due to the significant amount of capital investments we are making in our utility infrastructure and increasing operating costs, we filed general rate cases in Washington and Idaho in January 2009 and Oregon in June 2009.

The following is a summary of our authorized rates of return in each jurisdiction:

Jurisdiction and service	Implementation Date

		Authorized Overall Rate of Return	Authorized Return on Equity	Authorized Equity Level
Washington electric and natural gas	January 2009	8.22%	10.2%	46%
Idaho electric and natural gas	August 2009	8.55%	10.5%	50%
Oregon natural gas	April and November 2008	8.21%	10.0%	50%

Washington General Rate Cases

In September 2008, we entered into a settlement stipulation with respect to our general rate case that was filed with the WUTC in March 2008. Other parties to the settlement stipulation were the staff of the WUTC, Northwest Industrial Gas Users, and the Energy Project. The Industrial Customers of Northwest Utilities (ICNU) joined in portions of the settlement and the Public Counsel Section of the Washington Attorney General s Office (Public Counsel) did not join in the settlement stipulation. This settlement stipulation was approved by the WUTC in December 2008. The new electric and natural gas rates became effective on January 1, 2009. As agreed to in the settlement, base electric rates for our Washington customers increased by an average of 9.1 percent, which is designed to increase annual revenues by $32.5 million. Base natural gas rates for our Washington customers increased by an average of 2.4 percent, which is designed to increase annual revenues by $4.8 million.

The settlement was based on an overall rate of return of 8.22 percent with a common equity ratio of 46.3 percent and a 10.2 percent return on equity. Our original request was based on a proposed overall rate of return of 8.43 percent with a common equity ratio of 46.3 percent and a 10.8 percent return on equity.

AVISTA CORPORATION

On January 27, 2009, Public Counsel filed a Petition for Judicial Review (in Thurston County Superior Court) of the WUTC s December 2008 order approving our multiparty settlement. Public Counsel raised a number of issues that were previously argued before the WUTC. These include whether settlement costs associated with resolving the dispute with the Coeur d Alene Tribe were prudent and whether recovery of such costs would constitute illegal retroactive ratemaking. Public Counsel also questioned whether the WUTC s decision to entertain supplemental testimony by us to update our filing for power supply costs during the course of the proceedings was appropriate. Finally, Public Counsel argued that the settlement improperly included advertising costs, dues and donations, and certain other expenses.

The appeal itself did not prevent the new rates from going into effect. The appeals process may take several months and a decision is not expected until later in 2009 or early 2010. The court will either affirm the decision of the WUTC in its entirety or reverse the decision, in whole or in part, and possibly remand the matter back to the WUTC for further consideration, which could possibly result in small refunds to customers and regulatory disallowance of the Washington portion, approximately $25.2 million, that we have agreed to compensate the Tribe. We cannot predict the potential impact the outcome of this matter could ultimately have on our results of operations, financial condition or cash flows.

In January 2009, we filed a general rate case with the WUTC requesting to increase base electric rates for our Washington customers. In the general rate case filing, we requested a net electric rate increase of 8.6 percent. The net electric rate increase is based on a requested 16.0 percent increase in billed rates with an offsetting 7.4 percent reduction in the current Energy Recovery Mechanism (ERM) surcharge. We also requested a 2.4 percent increase in natural gas rates. The filing is designed to increase annual base electric service revenues by $69.8 million ($37.5 million net after considering the reduction in the current ERM surcharge) and increase annual natural gas service revenues by $4.9 million. Our request is based on a proposed rate of return on rate base of 8.68 percent, with a common equity ratio of 47.5 percent and an 11.0 percent return on equity. The WUTC generally has up to 11 months to review a general rate case filing.

Idaho General Rate Cases

In August 2008, we entered into an all-party settlement stipulation with respect to our general rate case that was filed with the IPUC in April 2008. This settlement stipulation was approved by the IPUC in September 2008. The new electric and natural gas rates became effective on October 1, 2008. As agreed to in the settlement, base electric rates for our Idaho customers increased by an average of 12.0 percent, which is designed to increase annual revenues by $23.2 million. Base natural gas rates for our Idaho customers increased by an average of 4.7 percent, which is designed to increase annual revenues by $3.9 million.

In June 2009, we entered into an all-party settlement stipulation with respect to our general rate case that was filed with the IPUC in January 2009. This settlement stipulation was approved by the IPUC in July 2009. The new electric and natural gas rates became effective on August 1, 2009. As agreed to in the settlement, base electric rates for our Idaho customers increased by an average of 5.7 percent, which is designed to increase annual revenues by $12.5 million. Offsetting the base electric rate increase was an overall 4.2 percent decrease in the current Power Cost Adjustment (PCA) surcharge, which is designed to decrease annual PCA revenues by $9.3 million, resulting in a net increase in annual revenues of $3.2 million. Base natural gas rates for our Idaho customers increased by an average of 2.1 percent, which is designed to increase annual revenues by $1.9 million. Offsetting the natural gas rate increase for residential customers was an equivalent purchased gas adjustment (PGA) decrease of 2.1 percent. Large general services received a PGA decrease of 2.4 percent and interruptible services received a PGA decrease of 2.8 percent. The overall PGA decrease resulted in a $2.0 million decrease in annual PGA revenues, resulting in a net decrease in annual revenues of $0.1 million. The Purchased Gas Adjustments are designed to pass through changes in natural gas costs to our customers with no change in gross margin or net income.

Our January 2009 request was for an electric rate increase of 12.8 percent, which was designed to increase annual revenues by $31.2 million. Offsetting the electric rates increase was a decrease in the PCA surcharge of 5.0 percent, which was designed to decrease annual revenues by $12.3 million. We also requested to increase natural gas rates by an average of 3.0 percent, which was designed to increase annual revenues by $2.7 million.

The settlement was based on a rate of return of 8.55 percent with a common equity ratio of 50.0 percent and a 10.5 percent return on equity. Our January 2009 request was based on a rate of return of 8.8 percent with a common equity ratio of 50.0 percent and an 11.0 percent return on equity.

AVISTA CORPORATION

Oregon General Rate Cases

As approved by the OPUC in March 2008, natural gas rates for our Oregon customers increased 0.4 percent effective April 1, 2008 (designed to increase annual revenues by $0.5 million) and increased an additional 1.1 percent effective November 1, 2008 (designed to increase annual revenues by an additional $1.4 million).

In June 2009, we filed a general rate case with the OPUC requesting to increase natural gas rates for our Oregon customers. In the general rate case filing, we requested a natural gas rate increase of 11.6 percent. The filing is designed to increase annual natural gas service revenues by $14.2 million. Our request is based on a proposed rate of return on rate base of 8.96 percent, with a common equity ratio of 51.5 percent and an 11.0 percent return on equity. The OPUC generally has up to 10 months to review a general rate case filing.

Purchased Gas Adjustments

Effective June 1, 2009, natural gas rates decreased 6.7 percent in Idaho and effective August 1, 2009 rates decreased 2.1 percent. Effective June 1, 2009, natural gas rates decreased 8.1 percent in Washington. Effective November 1, 2008, natural gas rates decreased 4.1 percent in Oregon. PGAs are designed to pass through changes in natural gas costs to our customers with no change in gross margin (operating revenues less resource costs) or net income. In Oregon, we absorb (gain or loss) 10 percent of the difference between actual and projected gas costs for unhedged supply. In October 2008, the OPUC issued an order based upon an extensive review of the current PGA mechanism. The order reaffirmed the current mechanism and included several minor modifications that we believe will not have a significant impact on our gas purchasing and hedging strategies or net income. Total net deferred natural gas costs were a liability of $38.9 million as of June 30, 2009, an increase from $18.6 million as of December 31, 2008.

Oregon Senate Bill 408

The OPUC established rules in September 2007 related to Oregon Senate Bill 408 (OSB 408), which was enacted into law in 2005. These rules direct the utility to establish an automatic adjustment clause to account for the difference between income taxes collected in rates and taxes paid to units of government, net of adjustments, when that difference exceeds $100,000. The automatic adjustment clause may result in either rate increases or rate decreases and applies only to taxes paid and collected on or after January 1, 2006.

In February 2008, we reached a settlement stipulation with respect to the refund liability for the 2006 tax report that was approved by the OPUC in April 2008. The approved settlement provided for a refund to customers of $1.5 million, including interest for the period June 2008 through May 2009.

In October 2008, we filed the tax report for 2007 showing taxes paid to be less than taxes collected by $2.0 million before interest. We claimed that no refund should be made in connection with the 2007 tax report, asserting that such a refund would violate the fair and reasonable standard provided for under OPUC rules. In January 2009, we reached a settlement stipulation that would result in no refund related to the 2007 tax report. A joint brief related to the settlement was filed in February 2009. On April 10, 2009, the settlement stipulation was rejected by the OPUC and we were ordered to file tariffs to refund $2.0 million plus approximately $0.4 million of interest. After tariffs are filed, we are allowed to file a request to terminate or modify the refund, arguing that the resulting rates would not be fair or sufficient. On April 14, 2009, the OPUC issued an order adopting a temporary rule amendment changing the time period used for the earnings review to evaluate the fair and reasonable standard from the applicable tax year to the period during which the automatic adjustment clause would be in effect. On May 5, 2009 we filed a claim that the refund would result in confiscatory rates, and proposed that no refund be implemented. On May 8, 2009, the OPUC suspended the refund tariff until December 1, 2009, and established a procedural schedule. On June 15, 2009, we filed our opening testimony. OPUC Staff and Intervenor s opening testimony was filed on July 28, 2009. We have recorded a potential refund liability related to the 2008 tax report of $1.4 million. However, any final determination of refunds or surcharges to customers will ultimately be determined based on final calculations for the 2008 tax year.

Natural Gas Decoupling

In January 2007, the WUTC approved the implementation of a natural gas decoupling mechanism. Because our rate structure provides for recovery of the majority of fixed costs on a per-therm (sales volume) basis, energy efficiency and conservation objectives are directly at odds with the recovery of fixed costs, which do not vary with the volume of natural gas sold. Decoupling separates the direct link between natural gas sales volume and the recovery of the fixed cost of providing service to our customers. The decoupling mechanism allows us to recover lost margin resulting from lower usage by Washington customers due to conservation and price elasticity. However, the mechanism does not provide rate adjustments related to abnormal weather. The rate adjustment in any one year is limited to no more than 2 percent. Our most recent decoupling rate adjustment became effective November 1, 2008 and is designed to recover $0.7 million from Washington residential and small commercial customers over a twelve month period. This represents an incremental rate increase of 0.3 percent, reflecting 90 percent of the lost margin during the period July 2007 through June 2008.

AVISTA CORPORATION

The decoupling mechanism was a two and one half year pilot that began in January 2007. We filed a request with the WUTC on April 30, 2009 to: 1) continue the natural gas decoupling mechanism on a permanent basis, and 2) temporarily extend the mechanism beyond the end of the pilot period (June 30, 2009) until the WUTC decides whether or not to extend it on a permanent basis. On June 30, 2009 the WUTC issued an order granting the temporary extension. As part of the general rate case filing made earlier this year, the WUTC will evaluate the results of the mechanism during the latter half of 2009 and decide on its continuance by the end of 2009.

Power Cost Deferrals and Recovery Mechanisms

The ERM is an accounting method used to track certain differences between actual power supply costs, net of the margin on wholesale sales and the amount included in base retail rates for our Washington customers. In periods where we are a net seller of wholesale power, market prices lower than the prices included in rates negatively impacts the ERM. In periods where we are a net purchaser, market prices lower than the amount included in retail rates has a beneficial impact under the ERM.

This difference in net power supply costs primarily results from changes in:

- short-term wholesale market prices and sales and purchase volumes,
- the level of hydroelectric generation,
- the level of thermal generation (including changes in fuel prices), and
- retail loads.

The initial amount of power supply costs in excess of or below the level in retail rates, which we either incur the cost of, or receive the benefit from, is referred to as the deadband. The annual (calendar year) deadband amount is currently $4.0 million. We incur the cost of, or receive the benefit from, 100 percent of this initial power supply cost variance. We share annual power supply cost variances between $4.0 million and $10.0 million with customers. There is a 75 percent customers/25 percent Company sharing when actual power supply expenses are lower (rebate to customers) than the amount included in base retail rates within this band. There is a 50 percent customers/50 percent Company sharing when actual power supply expenses are higher (surcharge to customers) than the amount included in base retail rates within this band. To the extent that the annual power supply cost variance from the amount included in base rates exceeds $10.0 million, 90 percent of the cost variance is deferred for future surcharge or rebate. We incur the cost of, or receive the benefit from, the remaining 10 percent of the annual variance beyond $10.0 million without affecting current or future customer rates. The following is a summary of the ERM:

Annual Power Supply Cost Variability	Deferred for Future Surcharge or Rebate to Customers	Expense or Benefit to the Company
+/- $0 - $4 million	0%	100%
+ between $4 million - $10 million	50%	50%
-between $4 million - $10 million	75%	25%
+/- excess over $10 million	90%	10%

Under the ERM, we make an annual filing on or before April 1st of each year to provide the opportunity for the WUTC staff and other interested parties to review the prudence of and audit the ERM deferred power cost transactions for the prior calendar year. The ERM provides for a 90-day review period for the filing; however, the period may be extended by agreement of the parties or by WUTC order. In July 2009, the

WUTC issued an order, which approved the recovery of power cost deferrals under the ERM for 2008. Additionally, we must make a filing (no sooner than January 1, 2011), to allow all interested parties the opportunity to review the ERM, and make recommendations to the WUTC related to the continuation, modification or elimination of the ERM.

A provision of our ERM requires that in the case of a major plant outage (below 70 percent availability), there may be a disallowance of fixed costs during the outage period if the outage resulted from our imprudent actions, or if actual fixed costs are below the level used to calculate base rates. There is currently an extended outage at the coal-fired Colstrip generating plant of which we are a 15 percent owner. We believe the outage is not due to imprudent actions and we expect there to be no reduction in fixed costs during the plant outage.

We have a Power Cost Adjustment (PCA) mechanism in Idaho that allows us to modify electric rates on October 1 of each year with IPUC approval. Under the PCA mechanism, we defer 90 percent of the difference between certain

Table of Contents

AVISTA CORPORATION

actual net power supply expenses and the amount included in base retail rates for our Idaho customers. The October 1 rate adjustments recover or rebate power costs deferred during the preceding July-June twelve-month period. The PCA rate surcharge was 0.61 cents per KWh (designed to recover $21.7 million) for the period October 1, 2008 through September 30, 2009. The surcharge rate was lowered to 0.344 cents per KWh on August 1, 2009 to help mitigate the impact of the general rate increase that was also effective on that date. The surcharge rate is expected to remain in place until October 1, 2010, when it will be replaced by a new rate that will be proposed as part of the PCA report for the period July 1, 2009 through June 30, 2010.

The following table shows activity in deferred power costs for Washington and Idaho during the six months ended June 30, 2009 (dollars in thousands):

	Washington	Idaho	Total
Deferred power costs as of December 31, 2008	$ 36,952	$ 20,655	$ 57,607
Activity from January 1 June 30, 2009:			
Power costs deferred	91	7,587	7,678
Interest and other net additions	586	184	770
Recovery of deferred power costs through retail rates	(17,063)	(10,753)	(27,816)
Deferred power costs as of June 30, 2009	$ 20,566		