

3. On January 31, 2006, the Company filed its Petition for continuation of the ERM, with certain modifications, together with supporting testimony. The filing satisfies a condition in the ERM Stipulation, as well as a condition established in the Commission's Order No. 05, "Approving and Adopting Settlement Agreement with Conditions," entered on December 21, 2005, in Avista's most recent general rate proceeding, Docket Nos. UE-050482 and UG-050483. In paragraph 177 of that order, the Commission required Avista to file a petition on or before January 31, 2006, to initiate further review of the ERM.

4. At the prehearing conference held on February 21, 2006, the Industrial Customers of Northwest Utilities ("ICNU") was granted permission to intervene and participate along with Staff and Public Counsel.

5. After analysis of the filing, and the pre-filing of testimony by Staff, ICNU, and Public Counsel, all parties commenced discussions for purposes of resolving or narrowing the contested issues in this proceeding in a settlement conference held April 26, 2006.

6. The Parties have reached agreement on all issues in this proceeding and wish to present their agreement for the Commission's consideration. The Parties therefore adopt the following Settlement Agreement in the interest of expediting the disposition of this proceeding.

III. AGREEMENT

6. Energy Recovery Mechanism. Certain modifications to the existing Energy Recovery Mechanism (ERM) will be implemented as follows:

- (A) Deadband/Sharing Bands. – The \$9 million annual deadband (referred to as the "Company Band" in the ERM Stipulation) will be reduced to \$4 million, and a 50%/50% sharing between the Company and its customers will apply to differences between actual and base power supply costs between \$4 and \$10 million. A 90% Customer/10% Company sharing

will apply to all differences between actual and base power costs in excess of \$10 million.

- (B) Transmission Revenues and Expenses. –The current ERM tracks the variation in net power supply expense, including purchased power and fuel expense, less wholesale sales revenue. Under the Settlement, transmission revenues (FERC Account 456.100) and expenses (FERC Account 565) will be included in net power costs and expenses under the ERM. Accordingly, monthly variations in transmission revenues and expenses will be included in the monthly ERM calculations.
- (C) Transmission Fixed-Cost Component. – The fixed-cost component of transmission approved for inclusion in rates in the then most recent rate case that is used to deliver power to the Company’s system, as well as that used to provide access to the market for the Company’s excess power, will be included in the retail revenue credit in the ERM. Until changed, the retail revenue credit, including the transmission fixed costs, is \$39.03/MWh.
- (D) Long-Term Power Supply Contracts. – For any new power contract, or any power contract that has been renewed or extended, with a term longer than two years and of more than 50 megawatts (MW), costs in excess of the lower of the average embedded cost of power supply determined in the then most recent rate case (currently \$32.89/MWh) or the average market rate during the contract (based on the average annual price of the Dow Jones Mid-Columbia Firm Index), shall be excluded from actual power supply costs until such time as the contract is incorporated in base rates pursuant to a general rate case. Such costs, if approved, would be recoverable only on a going-forward basis. The contracting of up to 50 aMW under Avista’s current renewable energy RFP is exempt from this limitation.
- (E) Treatment of Major Plant Outages. – For recovery of fixed costs associated with the Kettle Falls, Colstrip 3 & 4, and Coyote Springs 2 generating plants when the plants fail to meet a 70% availability factor during the ERM review period, the Company must demonstrate that: (1) the fixed costs set in rates were in fact incurred for the time the plants had an outage that reduced the availability factor below 70%; and (2) the outage was not the result of imprudent actions on the part of the Company. The fixed costs for each of the plants include return on rate base net of tax, depreciation expense, and operation and maintenance expense not included in the net power costs and other production costs related to these plants. To the extent that the actual fixed costs are below the level used to calculate base rates, or to the extent the outage was the result of imprudent actions and some level of cost is disallowed these disallowed costs or reductions in actual costs are to be subtracted. No adjustment is necessary to the normal method of calculating the retail revenue credit and the same

retail revenue credit factor will be used that would have been used absent such an event.

- (F) Brokerage Fees. – Broker fees include fees paid to third-party brokers who facilitate electricity and natural gas turbine fuel purchases and sales. Those fees are a component of the Company’s power supply expense and will vary from the amount embedded in rates. Monthly variations in broker fees will be included in the monthly ERM calculations.
- (G) Effective Date of Revisions to ERM. – The Parties agree that all revisions to the ERM resulting from this Settlement shall be effective beginning January 1, 2006, and shall remain in effect until the conclusion of the review described in paragraph (H), except as otherwise specified in this Agreement.
- (H) Review of ERM. – Avista will initiate a filing not sooner than five (5) years from the date this Settlement is approved, to allow all interested parties the opportunity to review the ERM, and make recommendations to the Commission related to the continuation, modification or elimination of the mechanism.
- (I) ERM Stipulation. - Except as expressly provided herein or in previous orders of the Commission, the ERM Stipulation shall remain in full force and effect.

7. Matters Deferred to Next General Rate Case (GRC).

With respect to matters deferred to the Company’s next general rate case (GRC), the parties agree as follows:

- (1) The Company agrees to file testimony in its next GRC on the cost of capital impact of the ERM;
- (2) The Company will file a prudence case on its hedging strategy for power purchases and purchases of gas used for power generation, on a prospective basis, in its next GRC;
- (3) Consideration of the allocation of common costs related to the retail revenue credit will be addressed in the next GRC; and
- (4) Consideration of a production property adjustment will be addressed in the next GRC.

IV. EFFECT OF THE SETTLEMENT AGREEMENT AND PROCEDURE

8. Binding on Parties. The Parties agree to support the terms of the Settlement Agreement throughout this proceeding, including any appeal, and recommend that the Commission issue an order adopting the Settlement Agreement contained herein. The Parties understand that this Settlement Agreement is subject to Commission approval. The Parties agree that this Settlement Agreement represents a compromise in the positions of the Parties. As such, conduct, statements and documents disclosed in the negotiation of this Settlement Agreement shall not be admissible evidence in this or any other proceeding.

9. Integrated Terms of Settlement. The Parties have negotiated this Settlement Agreement as an integrated document. Accordingly, the Parties recommend that the Commission adopt this Settlement Agreement in its entirety. Each Party has participated in the drafting of this Settlement Agreement, so it should not be construed in favor of, or against, any particular Party.

10. Procedure. The Parties shall cooperate in submitting this Settlement Agreement promptly to the Commission for acceptance. The Parties shall make available a witness or representative in support of this Settlement Agreement. The Parties agree to cooperate, in good faith, in the development of such other information as may be necessary to support and explain the basis of this Settlement Agreement and to supplement the record accordingly.

The Parties agree to stipulate into evidence the prefiled direct testimony and exhibits of each of the Parties, together with such evidence in support of the Agreement as may be offered at the time of the hearing on the Settlement.

If the Commission rejects all or any material portion of this Settlement Agreement, or adds additional material conditions, each Party reserves the right, upon written notice to the Commission and all parties to this proceeding within seven (7) days of the date of the Commission's Order, to withdraw from the Settlement Agreement. If any Party exercises its right of withdrawal, this Settlement Agreement shall be void and

of no effect, and the Parties will support a joint motion for an expedited procedural schedule to address the issues that would otherwise have been settled herein.

11. No Precedent. The Parties enter into this Settlement Agreement to avoid further expense, uncertainty, and delay. By executing this Settlement Agreement, no Party shall be deemed to have accepted or consented to the facts, principles, methods or theories employed in arriving at the Settlement Agreement, and except to the extent expressly set forth in the Settlement Agreement no Party shall be deemed to have agreed that such a Settlement Agreement is appropriate for resolving any issues in any other proceeding.


12. Public Interest. The Parties agree that this Settlement Agreement is in the public interest and results in rates which are fair, just, reasonable and sufficient.

13. Publicity. All Parties agree: (1) to provide all other Parties the right to review in advance of publication any and all announcements or news releases at the time of filing of the Settlement that any other Party intends to make about the Settlement (with the right of review to include a reasonable opportunity to request changes to the text of such announcements) and (2) to prominently include in any news release or announcement a statement that the Parties' recommendation to approve the Settlement is not binding on the Commission itself.

14. Execution. This Settlement Agreement may be executed by the Parties in several counterparts and as executed shall constitute one agreement.

Entered into this 7th day of June, 2006.

Company:

By: 
David J. Meyer
VP, Chief Counsel for Regulatory and
Governmental Affairs

Staff:

By: _____
Gregory J. Trautman
Assistant Attorney General
Counsel for Commission Staff

Office of Public Counsel:

By: _____
Simon ffitch
Public Counsel Section
Office of Washington Attorney General

ICNU:


By: _____
Bradley Van Cleve
Davison Van Cleve, PC

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