Review of Executive Officer Compensation

February 28, 2012

Provided Pursuant to Order No. 06
Dockets UE-110876 & UG-110877

AVISTA Utilities

Background

This report is being provided pursuant to the Washington Utilities and Transportation Commission Order No. 6 in Dockets UE-110876 & UG-110877.

Avista is to provide the following information per Order No. 6, Paragraph 42:

- A description of current executive compensation, including but not limited to, base salary, non-equity incentive compensation, and incentive compensation. This description should state what elements and amounts are included in rates for the Company and what elements and amounts are not recovered through rates.

- A description of how levels of compensation are set. This description should include discussion of the basis for selecting ostensibly comparable utilities that were surveyed, state what those survey results showed, and explain how the results relate to Avista. Avista is also required to state whether executive compensation paid by any Pacific Northwest investor-owned (e.g., Puget Sound Energy, PacifiCorp, et cetera) or publicly-owned utilities (e.g., Seattle City Light, Tacoma Power, Public Utility District No. 1 of Snohomish County, and the Bonneville Power Administration) were considered and if not, explain why not

- An explanation of why the existing levels of executive compensation are appropriate for recovery in utility rates.

Issues Addressed

1. **Executive Officer Compensation Description**
   A description of executive officer compensation, including what elements and amounts are included in customer rates versus amounts which are excluded from customer rates.

2. **Setting of Executive Officer Compensation Levels**
   A description of how levels of compensation are set, including the basis for selecting comparable utilities that were surveyed, what those survey results showed, and how the results relate to Avista. Additional information is included, as requested, on whether executive officer compensation paid by any Pacific Northwest investor-owned or publicly-owned utilities were considered comparable and if not, why not.

3. **Appropriate Level of Executive Officer Compensation in Rates**
   An explanation of why the existing levels of executive officer compensation is appropriate for recovery in rates.

Attachments:

A. Avista Corporation Notice of 2012 Annual Meeting and Proxy Statement
B. 2011 Executive Officer Short Term Incentive Plan for 2011
C. Confidential - Total Utility Executive Officer Base Salary and Incentive Amounts in Rates
D. Avista Corporation Executive Officer Long Term Incentive Plan
E. 2011 Employee Benefit Summary
F. Confidential - Total Executive Officer Base Pay Summary
G. Confidential - Towers Watson Total Direct Compensation Review

1. Executive Officer Compensation Description

Executive officer compensation is comprised of the following components:

- Base Salary
- Short Term Incentive Plan (STIP)
- Long Term Incentive Plan (LTIP)
- Benefits Package

A summary of total executive compensation is provided in Illustration 1 below.[1] The compensation components for 2011 for each of the top five officers, reported in the proxy report to shareholders, are shown separately in the table, and the total salary and incentive pay for the remaining officers are shown on Line 8 of the table. The total salary and incentives for all officers is shown on Line 9. The amount of the total compensation that is currently included in retail rates is shown on Lines 10 through 12.

Illustration 1 (in thousands)

	A	B	C	D	E	F	G	H
1	**Officer**	**Base Pay**	**STIP**	**LTIP**	**Base Pay, STIP & LTIP**	**Pension/ Deferred Comp[2]**	**Other[3]**	**Total Compensation**
2	Chairman of the Board, President and CEO	$662	$537	$1,356	**$2,555**	$890	$49	**$3,494**
3	Sr. Vice President & CFO	$341	$185	$331	**$857**	$77	$11	**$945**
4	Sr. Vice President and Environmental Compliance Officer, Utility President	$304	$164	$331	**$799**	$301	$13	**$1,113**
5	Sr. Vice President, General Counsel & Chief Compliance Officer	$289	$156	$331	**$776**	$124	$11	**$911**
6	Sr. Vice President and Corporate Secretary	$254	$137	$373	**$764**	$187	$11	**$962**
7	**Executive Officer Compensation**	**$1,850**	**$1,179**	**$2,722**	**$5,751**	**$1,579**	**$95**	**$7,425**
8	Other Officers	$1,823	$657	$1,273	$3,753			
9	**Total 2011 Officer Salary & Incentives**	**$3,673**	**$1,836**	**$3,995**	**$9,504**			
10	**Salary and Incentives in Rates (System) 1/1/2012**	**$3,357**	**$588**	**$0**	**$3,945**			
11	WA Electric Portion	$1,601	$276	$0	$1,877			
12	WA Gas Portion	$452	$77	$0	$529			

[1] The information in this table for the top five officers is based on information shown in the 2012 Proxy Statement, plus salaries and incentives for the remaining officers. This table excludes company benefits such as pension, medical, etc. See Attachment F for further information.

[2] Represents the change in pension amounts between 12/31/10 and 12/31/11 at net present value. The increase in the value of pension benefits is due to one additional year of service, higher final average earnings, the passage of time, and changes in interest and mortality assumptions for calculating present values. The costs detailed in this column are not included in rates. What is included in rates is the Non-SERP annual pension expense. Deferred Compensation is not included in rates.

[3] Represents the employer matching contributions under the Executive Deferred Compensation Plan. The Investment and Stock Option Plan 401(k) plan and executive one leave cash outs.

The table shows that of the total officer salaries and incentives shown on Line 9, Column E approximately 42% of that amount is included in retail rates for customers in Washington, Idaho and Oregon. Approximately 25% of Line 9, Column E amount is included in Washington retail rates.[4] The remaining salaries and incentives are not charged to customers through retail rates. The majority of base salary is included in retail rates, and the remainder is allocated to non-utility (subsidiary) operations. A portion of the STIP is included in retail rates, and the majority is paid by shareholders. None of the LTIP is included in rates; 100% is paid by shareholders. Additional details are provided in Confidential Attachment C.

A description of each of the compensation components is provided below. In addition, pages 27-34 of the Avista Notice of 2012 Annual Meeting and Proxy Statement filed with the SEC February 29, 2012 (Attachment A), provides a detailed explanation of Avista's executive officer compensation.

Base Salary

Annual base salaries are provided for services rendered during the year. As an executive's level of responsibility within the Company increases, so does the percentage of total compensation that is linked to performance. For example, Illustration 2 below shows that 25% of the total salary and incentives of the CEO is provided in Base Salary, with the remainder of the compensation at risk through incentive compensation. By comparison, officers other than the Top 5, receive 48% of their total salaries and incentives through Base Salary. What this means is customers are paying for a lower proportion of total compensation for the Top 5 officers.

Illustration 2

Name	Base Salary	Annual Cash Incentive	Long-Term Equity Award
CEO	25%	23%	52%
Top 5 Executive Officers (excluding CEO)	36%	22%	42%
All Other Officers	48%	19%	33%

Source: 2012 Proxy Statement, Page 30 (Attachment A)

Base salary ranges for executive officers are determined according to position and responsibility by using market data provided by the Company's independent executive compensation consultant, Towers Watson[5]. See Section 2, "Setting of Executive Officer Compensation Levels" for additional information on how levels of executive officer compensation are set.

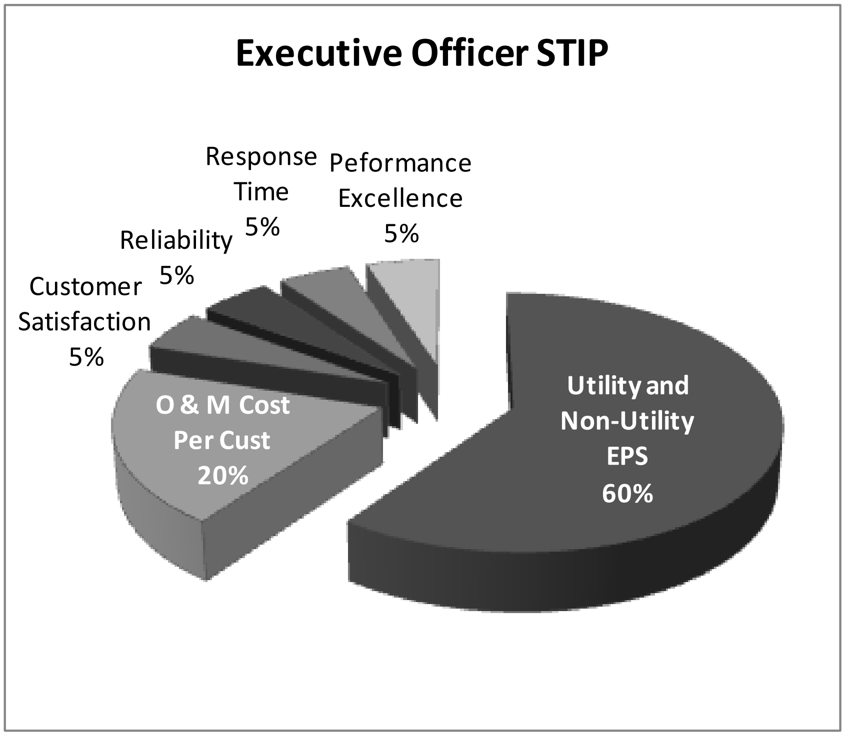
Executive Officer Short Term Incentive Plan (STIP)

[4] Represents amount of base salary and short term incentive amounts included in base rates as of 1/1/2012.

[5] Towers Watson is a leading global professional services company that helps organizations assess compensation levels in light of competitive benchmarks. Towers Watson is a nationally recognized independent provider of executive compensation advisory services, with no legal or financial connection with any other service provider. Towers Watson does not perform any work for the Company outside of its role as consultant to the Compensation Committee.

The 2011 Executive Officer Short Term Incentive Plan (STIP) was designed to align the interests of senior management with both shareholder and customer interests. The STIP has five operational components, plus two earnings-per-share (EPS) components, as shown in Illustration 3.

Illustration 3



The total amount associated with utility operational components is 40% and is broken down as follows: 20% O&M Cost Per Customer, 5% Customer Satisfaction, 5% Reliability, 5% Response Time and 5% Performance Excellence. The earnings-per-share components account for 60% of the total opportunity and are broken out into 50% utility earnings-per-share and 10% non-utility earnings-per-share. Only the operational components (40%) are proposed to be included in retail rates, because they reflect measures that are designed to drive cost-control, and delivery of safe, reliable service with a high level of customer satisfaction. The utility and non-utility earnings components are excluded from rates. For additional information on the STIP, see Attachment B.

Operations Components

The utility operational goal components in the 2011 Executive Officer Short Term Incentive Plan (Non-Equity) were as follows:

1. O & M Cost per Customer (20% of STIP):
   This measure provides an incentive to keep actual O&M costs as low as possible. The 2011 STIP placed emphasis on aggregate utility costs per customer to encourage company-wide teamwork and consistent results in order to keep costs reasonable. The O&M Cost per Customer target is based on the projected number of customers, targeted O&M expense and a

savings mechanism between employees and the Company. There is no payment under this portion of the plan if the minimum performance level is not achieved

2. Customer Satisfaction (5% of STIP):
The customer satisfaction rating measures overall customer satisfaction with the service they received during recent contact with the Company. The rating is derived from a "Voice of the Customer Survey", which is conducted each quarter by an independent agency. The measure is widely used in the industry for external reporting. The Company uses a combination of the "satisfied" and "very satisfied" ratings, rather than use the standard "satisfied" rating, which is typically used in the industry. By combining these two measures it actually makes the target more difficult to achieve. This element of the plan is set as a "meets" or not meets target. There is no payment under this portion of the plan if the target is not achieved.

3. Reliability Measure (5% of STIP):
Providing reliable service levels for our customers is also important. This target in the STIP is a measure that tracks how quickly the Company restores outages, how frequently customers are affected by outages and what percent of customers are experiencing more than three sustained outages per year. We combined three common industry indices in order to balance our focus of electric reliability. The Company tracks the average restoration time for sustained outages that affect our customers (CAIDI) and the average number of sustained outages per customer (SAIFI). The third metric is fairly new to the utility industry and measures the percentage of customers that experience more than three sustained outages in the year (CEMI[3]). We chose this level of outages over others because industry data received from JD Power's customer service surveys indicate that customers are more apt to be dissatisfied after three outages. Each metric has a set target to achieve and then are weighted equally (one-third of 100%) and combined into one index. Focusing on these measurements enables the Company to direct our resources appropriately and efficiently in order to contain costs and plan for future infrastructure upgrades that will benefit the customer. There is no payment under this portion of the plan if the target is not achieved.

4. Response Time (5% of STIP):
This metric measures the percentage of time the Company responds within targeted time goals for dispatched natural gas emergency calls. The Company tracks the time between the receipt of the call to the time our crew or serviceman arrives on-site, assesses the situation and reports back to dispatch. The Company tracks two types of emergency calls: priority 1 (blowing gas, explosions and/or fires, etc) and priority 2 (inside or outside odors, runaway furnaces, etc). The primary objective is customer and public safety while consistently treating customers the same throughout our service territory. There is no payment under this portion of the plan if the target is not achieved.

5. Performance Excellence (5% of STIP):
This metric combined two separate measures into one. By the end of the year, the objective was to implement or complete 92 project milestones and through process improvements achieve

$6.2 million in value to redeploy where needed[6]. The metric demonstrates the Company's commitment to continuously look for opportunities for efficiencies in order to keep costs reasonable for our customers in the long term. There is no payment under this portion of the plan if the target is not achieved.

The utility operational component metrics and allocations have varied over time and payouts associated with such components borne by customers and included in rates (which will be addressed later) have also varied over time.

Earnings-Per-Share Components

The Utility and Non-Utility EPS components of the STIP are summarized below:

1. Utility Earnings Per Share (EPS) (50%):
   This award will depend on attaining EPS goals for the utility operations. The actual amount paid, related to the utility EPS target, could increase (up to 150% of the utility EPS target award) or decrease (as low as 0% of the utility EPS target award) depending on the Company's actual performance.

2. Non-Utility Earnings Per Share (EPS) (10%):
   This award will depend on attaining EPS goals for non-utility operations. The actual amount paid, related to the non-utility EPS target, could increase (up to 150% of non-utility EPS target award) or decrease (as low as 0% of the non-utility EPS target award) depending on the Company's actual performance.

For information on all executive short term payouts for 2011 (paid in 2012) included in retail rates, see Confidential Attachment C - Total Utility Executive Officer Base Salary and Incentive Amounts in Rates.

Executive Officer Long Term Incentive Plan (LTIP)

The current Long Term Incentive Plan (LTIP) awards are based on 25% restricted common stock units and 75% through performance based common stock equity awards. As with all the components of executive officer compensation, the Compensation Committee determines all material aspects of the long-term incentive reward – who receives the reward, the amount of the reward, the timing of the award as well as any other aspect of the award that may be deemed material. A summary of the components of the LTIP is provided below.

1. Restricted Stock (25% of LTIP):
   Executive Officers (other than the CEO) are awarded time-based restricted stock units that vest over a three-year period—each year 1/3 of the units vest and shares are issued on an annual basis provided the executive officer is employed on the last day of the vesting period. For the CEO, the restricted stock units vest in three equal annual increments, provided the CEO remains employed by the Company on the last day of each year of the

[6] Value represented above includes avoided costs, efficiencies with benefits redeployed in the utility, net present value of long-lived asset programs, re-invested sourcing benefits and power supply cost reductions.

three-year period. Vesting is also based on the attainment of a performance target so that the compensation qualifies as performance-based compensation and is tax-deductible by the Company. Dividend equivalents accrue on the unvested units and, if the executive officer, as well as the CEO, is employed on the last day of the vesting period, the dividend equivalents are paid in cash at the same time that the underlying units vest and are paid in shares. Therefore, if his or her employment ends prior to the last day of the vesting period, no units or dividend equivalents are earned.

2. Performance Based Equity Awards (75% of LTIP):
   Performance share awards are granted under the LTIP and will vest based on performance over a three-year period. The number of contingent shares varies based on the Company's three-year relative total shareholder return compared to the returns reported in the S&P 400 Utilities Index. Dividend equivalents are paid in cash based on the total number of units earned at the end of the performance cycle provided the performance goals are met. Therefore, if the total shareholder return does not meet the threshold performance level, then no units or dividend equivalents are earned.

See Attachment D, Avista Corporation Executive Officer Long Term Incentive Plan, for additional details related to these components.

Benefits Package

All regular employees, including executive officers, are eligible for the Company's Qualified Defined Benefit plan, the Company's 401(k) plan, health and dental coverage, Company-paid term life insurance, disability insurance, paid time off and paid holidays. This benefit package offers several choices as to the type of medical plan, dental plan, life insurance, etc to determine the best fit for their circumstances. These plans are designed to be competitive with the overall market practices and are in place to attract and retain the talent needed in the business. As with all portions of the plan, the Company works with a third-party administrator to determine the annual rates for the Company and for each individual employee based on their elections.

Avista sponsors a self-funded medical benefit plan that provides various levels of coverage for medical, dental and vision. Avista encourages employees to take responsibility for their health care decisions and make lifestyle changes to avoid health care issues. The Company also encourages participants to adopt and maintain healthy lifestyles, and use health care wisely. Proactive programs are set up to help individuals change their behaviors and live a healthier life. The Company addresses this by using a health continuum; low risk (Wellness), moderate risk (Wellness, Lifestyle Health Coaching) and high risk (Disease Management, Case Management).

Retirement programs are crucial to attracting and retaining a skilled workforce within the utility industry. For active employees, a defined benefit pension plan and a defined contribution plan provide a balanced retirement opportunity for employees. The Company's Retirement Plan for Employees (defined benefit pension plan) provides a retirement benefit based upon employees' compensation and years of credited service. The retirement benefit is based on a participant's final average annual base salary for the highest 36 consecutive months during the last 120 months of service with the Company. The defined contribution plan, or 401(k) plan, provides tax deferred savings providing partial matching dollars for the first 6% invested by the employee (except for union employees). The matching feature encourages participation in the plan and provides incentive to maximize contributions to take full advantage of the Company match. These programs, in combination with pay and other benefits, are keys to attracting and retaining quality employees to run our business. See Attachment E, 2011 Employee Benefit Summary, for further additional details related to the benefit plans.

Other Executive Benefits

1. Supplemental Executive Officer Retirement Plan (SERP)
   In addition to the Company's retirement plan for all employees, the Company provides additional pension benefits through the SERP to executive officers of the Company who have attained the age of 55 and a minimum of 15 years of credited service with the Company. The costs associated with SERP are excluded from retail rates.

2. Deferred Compensation
   The Executive Officer Deferred Compensation plan provides the opportunity to defer up to 75% of base salary and up to 100% of cash bonuses for payment at a future date. This plan is competitive in the market, and provides eligible employees and executive officers with a tax-efficient savings method. The costs associated with Deferred Compensation are excluded from retail rates.

3. Perquisites
   Because the total compensation program for executive officers is fair and market competitive, the Company does not provide any additional benefits in the form of perquisites to the CEO or any other officer.

2. Setting of Executive Officer Compensation Levels

Avista is committed to providing a total compensation program that will attract and retain qualified people required to meet the needs and expectations of all utility stakeholders, including, but not limited to, customers, shareholders and regulators. The overarching compensation philosophy is that success is measured by the ability to hire, develop, and retain the most competent people to work in a very complex industry. In an effort to recruit and retain such people, Avista provides base salaries, performance-based award programs and benefits that are competitive in the marketplace as benchmarked against other similar-sized companies in regional and national markets.

The Compensation Committee of the Board of Directors is responsible for considering and approving, as well as overseeing the risk associated with, the compensation and benefits of executive officers of the Company. The Compensation Committee is composed of independent directors as defined by the rules of the New York Stock Exchange, and in addition, complies with the "outside director" requirement of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), and the "non-employee director" requirement of Rule 16b-3 under the Exchange act. Board members are elected based on factors that are in the best interest of the Company and its shareholders, including the knowledge, experience, integrity, and judgment of each candidate; the potential contributions of each candidate to the diversity of backgrounds, experience and competencies that the Board desires to have represented; each candidates' ability to devote sufficient time and effort to his or her duties as a director; independence and willingness to consider all strategic proposals and other criteria established by the Board, as well as any core competencies or technical expertise necessary to staff Board Committees.

The Compensation Committee employs an independent executive compensation consultant, Towers Watson, to assist them in their review of current executive pay practices. Because the Compensation Committee believes that its executive compensation consultant should be able to render advice to the Committee free of management's influence, the Compensation Committee has processes in place to assure independence. The consultant reports directly to the Compensation Committee on all executive compensation matters; regularly meets separately with the Compensation Committee outside the presence of management; and speaks separately with the Compensation Committee Chair and other Compensation Committee members between meetings, as necessary or as requested by the Compensation Committee.

Towers Watson assists in the following ways:

- Benchmarking pay practices among the peer group and providing a broader market perspective;

- Assessing the design of individual pay elements and the total pay program relative to the Company's objectives, market practices and other factors;

- Assisting the Compensation Committee in reviewing compensation recommendations prepared by management; and

- Providing the Compensation Committee with an outside perspective and, as appropriate, specific recommendations on program design.

Towers Watson presents information on current market practices and, as appropriate, provides recommendations for consideration by the Compensation Committee. See Confidential Attachment G Towers Watson Total Direct Compensation Review for additional information.

One of the core principles of the executive compensation program is to ensure management's interests are aligned with customers' and shareholders' interests to support long-term value creation. Accordingly, the 2011 Proxy included a "Say-On-Pay" proposal for a non-binding advisory vote giving shareholders the opportunity to vote on the executive compensation program. This proposal was approved by shareholders at the May, 2011 Shareholders' Annual Meeting, included as part of the Proxy, and a vote was cast. While the vote was advisory, and not binding on the company, the 94% shareholder approval vote sent a signal to management and the Compensation Committee that shareholders believe the executive compensation program is designed appropriately and is working to ensure management's interests are aligned with customers' and shareholders' interests.

The Compensation Committee believes that an effective total compensation plan should be structured to focus executive officers on the achievement of specific business goals set by the Company and to reward executive officers for achieving those goals. Considerable time is spent weighing various design options to ensure that top management's compensation is primarily performance-based, fair, and reasonable and does not encourage key decision makers to take excessive risks.

The Compensation Committee continues to review best practices and maintain appropriate alignment between pay and performance, with emphasis on long-term customer and shareholder value. This principle applies generally to our executive officer pay practices. The Compensation Committee takes into consideration external factors, such as the executive officer labor market, in order to create a program that is designed to attract, retain, and appropriately motivate the key employees of the Company who drive customer and shareholder value creation over the long term. The Compensation Committee also has a clear goal to ensure the overall program has a direct link between pay and performance and the right mix between fixed pay and pay at risk. See Section 1. Executive Officer Compensation Description for additional information.

Key compensation principles have been established to guide the design and ongoing administration of the Company's overall compensation program. According to these principles, the Company's compensation plans are intended to:

- Clearly identify the specific measures of Company performance that are likely to create long-term value for the Company's customers and shareholders;
- Structure incentive pay programs to reward specified levels of performance on measures designed to help the Company achieve:
  - Shareholder value targets;
  - Earnings per share targets;
  - Relative stock performance levels compared to peers;
  - Customer service targets;
  - Operational targets;
- Promote a culture of safety;
- Align elements of the incentive plans among all Company employees and executive officers;
- Maintain total compensation at market competitive levels; and
- Provide a range of payout opportunities based on the level of achievement of performance goals.

Competitive Analysis

When determining the types and amounts of compensation to be paid to executive officers, the Compensation Committee considers it important to provide an overall plan that reflects officers' compensation paid to similarly situated executive officers of peer companies, to maintain a competitive position within the energy/utility industry and to ensure the Company retains and attracts quality employees in key positions to lead the Company. To achieve this objective, the Compensation Committee works with Towers Watson to conduct an annual competitive review of its total compensation program for executive officers. Through the review process the Compensation Committee establishes levels of base salaries, short-term annual incentives, and long-term incentives that are generally targeted to be near the median of the amounts paid by a peer group, based on competitive data gathered by Towers Watson. However, the Compensation Committee exercises its discretion to set any one or more of the components at levels higher or lower than the median depending on an individual's role, responsibilities, and performance within the Company. The Compensation Committee believes this target positioning is effective to attract and retain our executive officers.

The Compensation Committee annually compares each element of total direct compensation, which includes base salary, annual cash incentives, and the value of long-term incentive grants, against a specific peer group of publicly-traded companies within the energy/utility industry. The companies in the peer group generally recruit individuals who are similar in skills and background to those the Company recruits to fill senior management positions, and are the companies with which Avista competes for executive officers and for shareholder investment.

Peer Group Companies
In 2011, the Compensation Committee asked Towers Watson to use its Energy Services Executive Officer Compensation database to perform a study of the compensation structure of comparable diversified energy companies with revenues between $1 billion and $3 billion to assure the data presented to the Compensation Committee reflected the Company’s general size and scope within the market. Organizations that benchmark compensation levels and practices typically select a sample of companies to gather this information. It is a widely-accepted practice that, for executive officer compensation benchmarking, it is important to select companies of similar size and with similar business characteristics, as these factors have been shown to have the strongest correlation to compensation opportunities. Governance groups, proxy advisors, and investors all view a peer group of companies within a size range of approximately .5x to 2x the companies size (as measured by revenues and secondarily market capitalization) to be an appropriate peer group. In addition, these organizations should be in the same industry (to the extent there are enough industry peers) and the peer group should be large enough that there are not statistical challenges with the data samples.

For benchmarking its executive officer group, Avista's primary source is the set of companies in the $1 billion to $3 billion standard data sample in Towers Watson's Energy Services Survey. This sample typically includes approximately 30 companies, the majority of which are investor-owned. The companies comprising the Compensation Peer Group for the 2011 study were:

Areva
Black Hills Corp
Covanta Holdings
CPS Energy
DPL Inc
Energen
E On US
First Solar
GenOn Energy
Hawaiian Electric
IDACORP Inc
Lower Colorado River Authority
Mirant
New York Power Authority
Nicor
Northwest Natural
NorthWestern Energy
OGE Energy
Oglethorpe Power
PNM Resources
Portland General Electric
Proliance Holdings
Regency Energy Partners LP
Salt River Project
Santee Cooper
Southern Union Company
Unisource Energy
Vectren
Westar Energy

The Compensation Committee also reviews compensation data from other regional peers in an effort to obtain as much intelligence on trends within the region, as well as the overall energy industry. The Compensation Committee uses all of these sources of data to help make informed decisions about market compensation practices.

As can be seen in the listing above, some local utilities were not considered in the review of market data. Puget Energy and PacifiCorp do not fall within the $1.0 billion to $3.0 billion range for peer comparisons. NW Natural, Portland General and IDACORP were included as part of the sample as they are participants in the survey, their revenues fall within this sample range and are investor-owned.

Typically those companies that are consumer-owned (PUDs, REAs, Co-ops, or Municipals) are excluded from the sample. Investor-owned utilities (IOUs) have different challenges than consumer-owned utilities, and as such, executive compensation programs are structured differently. As management of a publicly-traded investor-owned utility, the Company's officers have responsibilities to a broader constituency than our consumer-owned counterparts. Publicly-traded companies such as Avista answer not only to customers, but also to a broader investment community, including shareholders, as well as multiple state and federal regulatory agencies.

As a vertically integrated utility, Avista owns and operates not only an electric distribution system like our consumer-owned counterparts, but also owns and operates extensive generation and transmission facilities, all of which are used to serve customers in its multiple service areas in Washington, Idaho and Montana. Avista must manage and optimize its generation assets daily, keep existing assets operational and licensed for our customers, and develop future resource needs. Finally, as noted elsewhere, Avista must remain competitive in its compensation philosophy with other investor-owned utilities.

This requires Avista to attract and retain executive officers who have the requisite experience and knowledge. This also places additional demands on management in terms of disclosure and reporting. This includes understanding and oversight of reporting and compliance requirements of multiple jurisdictions (FERC, SEC, UTC, etc.) and multiple services (electric and natural gas), as well as increased accounting and other financial reporting requirements.

3. Appropriate Level of Executive Officer Compensation in Rates

Avista believes that the executive officer compensation programs are structured appropriately to meet the Company's business objectives. The executive officer compensation programs have played a material role in focusing the executive officer team on achieving solid financial results, maintaining system reliability, and delivering outstanding customer service. The compensation structure and levels serve as an appropriate tool to help motivate, retain and attract a highly experienced, successful executive officer team to manage the Company.

Ratepayers benefit from effective and capable utility management through innovation, efficiencies and leadership on strategic initiatives. Avista's total compensation philosophy creates the right focus for executive officers because a major portion of the overall earning opportunity is at risk. Employees and executive officers, as a whole, have to achieve the goals of the incentive plan for the plan to payout.

This tension in plan design helps motivate and focus all employees on the stated goals of the Company. In order to achieve additional level of compensation, employees have to keep focused on cost control, customer satisfaction and reliability within the system. Avista's existing total compensation plan is correctly weighted to retain current employees, while remaining competitive enough to attract new employees. A pay-at-risk component of compensation is not designed to pay out the full incentive opportunity every year, nor is it designed to have no payout for an extended period of time. Pay-at-risk plans are designed to help focus employees on making decisions that benefit the Company and its customers, while at the same time functioning as an integrated component of total compensation.

With the aid of Towers Watson, the Compensation Committee benchmarks each item in the compensation program against companies similar in size and business characteristics. Levels are set based on this research, experience levels and individual contributions. These factors are evaluated every year and adjusted as needed. The current levels of compensation are based on the results of that analysis and we believe are appropriate given our peer group.

Ratepayers receive several benefits from utility operational components of the incentive plan, making it appropriate for recovery. The plan focuses executive officers on key objectives of the Company, including reliability, customer service and operational efficiency which directly benefits customers, and overall operational efficiency translates into lower rates. The Short Term Incentive plan focuses our Executive officers on those areas that provide ratepayers benefit. Various options have been explored surrounding compensation and benefit programs to assess whether eliminating or reducing various programs would be appropriate given today's economic environment. If we were to eliminate the incentive plan, within one or two years after freezing wages, Avista would have to make upward market adjustments in order to bring current employee salaries up to appropriate levels. Finally, the Incentive Plan is part of a comprehensive benefits package provided to employees that make Avista an attractive employer to skilled, experienced talent in the marketplace.

The components of the executive officer LTIP are not in rates because it is based on elements focusing on shareholder value. The SERP and Deferred Compensation programs are also not in rates because they are benefits over and above what is offered to all employees as part of their total compensation package. However, the employee defined benefit pension plan is included in rates because it is a core benefit to all employees, which executives are a part of. As with all of the components of the overall compensation package, benefits are set at a level consistent with a peer group of companies, such that the Company can attract, motivate and retain the best employees to work at and manage the Company.

Conclusion

A considerable amount of time and effort goes into the development of Avista's overall executive compensation program. The Board of Directors has an independent Compensation Committee to oversee all aspects of the program, including base salaries, STIP, LTIP, SERP/deferred compensation, and other benefits. The Compensation Committee relies on additional analysis from an independent compensation expert, Towers Watson, for each pay element relative to the Company's objectives, market practices and other factors consistent within a peer group of utilities of similar size and characteristics as Avista. Finally, Avista's shareholders weigh in on the program through the "Say-

On-Pay" vote in the annual proxy, which passed in 2011 with a 94% approval rate. The level of compensation and benefits provided to executive officers is what other similar utilities offer.

The Company's compensation package is designed to be competitive with other organizations in the utility industry, and attract and retain qualified employees. The compensation programs are intended to align the executive officer interests with those of our shareholder and customers with the focus on achieving solid results, controlling costs, maintaining system reliability, and delivering outstanding customer service. In accordance with the pay-for-performance philosophy, the total compensation received by executive officers reflects corporate and operational performance measured against annual and long term performance goals.

As shown in Illustration 1, of the total salaries and incentive pay for all officers of $9.5 million in 2011, 41.6% or $3.8 million is included in retail rates on a system basis. Washington's portion of the overall salaries and incentive pay included in rates is $2.4 million, or 25% of the total salaries and incentive pay.