

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-11 _____

DOCKET NO. UG-11 _____

EXHIBIT NO. ____ (KSF-3)

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REPRESENTING AVISTA CORPORATION

AVISTA CORPORATION & AVISTA UTILITIES

EMPLOYEE INCENTIVE PLAN FOR 2010

PLAN PROVISIONS

Purpose: The Employee Incentive Plan (Plan) focuses on the customer while recognizing and rewarding employees for their contributions in achieving the goals of Avista.

Plan Year: January 1, 2010 – December 31, 2010

Eligibility:

- All regular full-time, regular scheduled part-time, regular seasonal and long-term (>6mo) temporary employees hired prior to October 1st and employed on December 31st of the plan year, are eligible to participate
- Subsidiary employees, short-term (<6mo) temporary, students, rehired retirees, contract services and contractor employees are not eligible to participate
- Details available in section *Exceptions to Eligibility and Circumstances for Proration*

Performance Measurements: The Employee Incentive Plan focuses on the customer. The Plan incorporates Operations & Maintenance Cost per Customer (O&M CPC) as a financial performance measurement plus two non-financial measurements: Customer Satisfaction Rating (CSR) and Reliability Index (RI). These performance measures help to maintain reliable cost-effective service levels essential for the long-term success of the Company.

Operations & Maintenance Cost per Customer (O&M CPC). This measure reflects operating efficiency and customer growth. The target is based on the projected number of customers and O&M expense for the Plan year. These components are combined to create the O&M Cost per Customer measure.

Customer Satisfaction Rating (CSR). This measure is derived from a Voice of the Customer survey, which is conducted each quarter by an independent agency. This survey is used to track satisfaction levels of customers that have had recent contact with our call center or service center.

Reliability Index (RI). This measure is derived from combining three indices that track average restoration time for sustained outages, average number of sustained outages per customer, and percent of customers experiencing more than three sustained outages per year. The industry names for the indices are *Customer Average Interruption Duration Index (CAIDI)*, *System Average Interruption Frequency Index (SAIFI)* and *Customer Experiencing Multiple Interruptions (CEMI³)*. We combined the three indices in order to balance our focus of reliability.

Award Opportunity: The incentive award is divided into three separate payout opportunities based on the performance measurements: Operations & Maintenance Cost per Customer (O&M CPC), Customer Satisfaction Rating (CSR), and Reliability Index (RI).

O&M Cost per Customer: Seventy-five percent (75%) of the employee's overall award opportunity depends on attaining an O&M cost goal measured by Cost per Customer (CPC). The measurement consists of three performance levels: threshold, target and exceed. The levels are setup on a sliding scale concept with threshold being set at 10% of the target, target set at 100% and exceed at 150% of target. Payments are interpolated on a straight-line basis for results between the threshold level and the maximum level. The actual amount paid to employees depends on the Company's actual performance and could range as low as 0% of the award opportunity or as high as 150% of the award opportunity. For example, if the Company achieves a CPC amount of \$342.57, employees would receive approximately 33% of the CPC portion (75%) of their overall award opportunity or if the Company achieves \$325.00, employees would receive the maximum of 150% of the CPC portion of the award. If the Company achieves an amount such as \$347.80 which is below threshold, employees would receive no award under the CPC portion of their opportunity.

Customer Satisfaction Rating and Reliability Index: The two non-financial measurements (Customer Satisfaction and Reliability) each have one performance level. Both are setup as a "pass or fail" metric. **Fifteen percent (15%)** of the employee's overall award opportunity depends on attaining a minimum Customer Satisfaction rating. The other **Ten percent (10%)** depends on attaining a minimum Reliability Index goal. Since there is no sliding scale or multiple performance levels for the non-financial measurements, the Company must pass or meet the performance target in order to receive the proportionate amount for each measurement. For example, if the Company achieves Customer Satisfaction with a 94% rating, employees would receive 15% of their award opportunity or if the Company achieves 90%, employees still receive 15%. If the Company achieves 88% which is below the target, employees would receive no award under the CSR portion of their overall award opportunity. This works the same way for the Reliability portion of their award.

Incentive Targets for 2010:

| Performance Measurements | O&M Cost per Customer | Customer Satisfaction Rating (satisfied/very satisfied) | Reliability Index (summation of SAIFI, CAIDI & CEMI ³) |
|--------------------------------------|-----------------------|--|---|
| % of Target Award Opportunity | 75% | 15% | 10% |
| Threshold 10% | \$345.99 | | |
| Target 100% | \$335.69 | 90% | 1.00 |
| Exceed 150% | \$330.80 | | |

Establish Targets: The executive officers of the Company in conjunction with management reviews and reestablishes the targets for each measurement on an annual basis. The computations are described below:

O&M Cost per Customer (CPC): Based on budget labor costs, job levels and corresponding incentive target award opportunities, we estimate the potential total target incentive amount (including taxes) at each performance level; threshold (10%), target (100%) and exceed (150%). We budget enough to cover most of the non-financial measures' potential incentive payout amount. Certain items are excluded from the total budgeted O&M cost such as A/R Sale, Pacesetter, payroll accrual, certain accounting adjustments, and the non-financial measures (customer satisfaction and reliability index) potential incentive amount which is already included in the O&M budget.

To compute the cost per customer targets, we use sharing bands where cost reductions are shared between the employee and the company and then we divide the resulting O&M level by a customer growth target. Using this method, we calculate the necessary savings and resulting cost per customer to achieve a 10%, 100% and 150% payout of the CPC portion of the plan.

Customer Satisfaction Rating (CSR): This measure is derived from a Voice of the Customer survey, which is conducted each quarter by an independent agency. We use the rating from question Q3 from the survey which measures the customer's *Overall Satisfaction* with the service they received. The Overall Satisfaction from surveys such as this is widely used in the industry for external reporting. In this Plan we use the average of the combined satisfied and very satisfied ratings, rather than use the industry standard of satisfied. The target is set at 90% very satisfied/satisfied for the customer's Overall Satisfaction rating.

Reliability Index (RI): In an effort to balance our focus of reliability between frequency, duration and percentage of customers with three or more outages, we combined three indices into one metric called a Reliability Index. This index combines SAIFI, CAIDI and CEMI³. CEMI³ is a new metric to the utility industry and measures the percentage of customers that experience more than three sustained outages in the year. 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.

To determine our target for the Reliability Index, we set a separate target for each metric, weigh them equally and combine them into one metric. In this Plan the target is set at 1.00. See the formula below:

$$\text{Index} = \frac{\text{CAIDI Target} / \text{CAIDI Actual}}{3} + \frac{\text{SAIFI Target} / \text{SAIFI Actual}}{3} + \frac{\text{CEMI}^3 \text{ Target} / \text{CEMI}^3 \text{ Actual}}{3}$$

The formula used to set the target for each metric is described below:

- *Customer Average Interruption Duration Index (CAIDI):* *outage duration multiplied by the number of customers affected for all sustained outages, divided by the number of customers which had sustained outages.* In this Plan we use a 5 year

average with a standard deviation of 0.72 (76% probability) to set the target which is 2 hours and 3 minutes restoration time.

- System Average Interruption Frequency Index (SAIFI): *the number of customers which had sustained outages (> 5 minutes), divided by the number of customers served.* In this Plan we use a 5 year average and a standard deviation of 0.72 (76% probability) to set the target which is 1.42 outages per customer.
- Customers Experiencing Multiple Sustained Interruptions more than 3 (CEMI³): *the total number of customers that experience more than 3 sustained outages per year, divided by total number of customers served.* In this Plan we use a 4 year average with a standard deviation of 0.72 (76% probability) to set the target of 13.2%.

Individual Target Award Opportunities: Each eligible employee has a target award opportunity based on their position and/or union/non-union status.

Non-union and Oregon union employees: Each eligible employee has a target award opportunity based on the market level assigned to their position. Target award opportunities are expressed as a percentage of annual base salary. The percentage varies by market level as indicated in the table below. Award payments are calculated based on the employee’s annual base salary and target award opportunity in effect as of December 31st.

Local #77 Union employees: Each eligible Local 77 bargaining unit employee has a target award opportunity expressed as a flat dollar amount rather than a percentage of annual base salary.

| | % of Base Pay by Market Level or Union Contract | | | | | | Union Local #77 |
|---------------|---|--------------|---------------|----------------|------------------|--------------|-----------------|
| | Levels 1 - 5 | Levels 6 - 8 | Levels 9 - 10 | Levels 11 - 12 | Levels 13 & over | Oregon Union | |
| Target | 5.0% | 7.0% | 9.0% | 11.0% | 17.0% | 5.0% | \$666.67 |

Incentive amounts in excess of 100% (up to 150%) of an individual’s target opportunity may be paid in the form of non-cash equivalents, at the discretion and approval of the Executive Council.

Example Award Calculation:

The Company achieved the targets indicated below:

- Cost per Customer = 33% on the sliding scale
- Customer Satisfaction = 88% = not met/fail
- Reliability Index = 1.36 = met/pass

Non-Union employee in level 7 Base pay = \$58,000 7.0% Target Opportunity = \$4,060

| | | | | | | | |
|---------------------------|---------|---|-----|---|------|---|------------|
| Cost per Customer | \$4,060 | X | 75% | X | 33% | = | \$1,004.85 |
| Customer Satisfaction | \$4,060 | X | 15% | | fail | = | \$0 |
| Reliability | \$4,060 | X | 10% | | pass | = | \$406.00 |
| Total Payout = \$1,410.85 | | | | | | | |

| | | | | | | | |
|-------------------------|----------|---|-----|---|------|---|----------|
| Cost per Customer | \$666.67 | X | 75% | X | 33% | = | \$165.00 |
| Customer Satisfaction | \$666.67 | X | 15% | | fail | = | \$0 |
| Reliability | \$666.67 | X | 10% | | pass | = | \$66.67 |
| Total Payout = \$231.67 | | | | | | | |

Distribution of Awards: Incentive awards, if earned, will be distributed after the February meeting of the Board of Directors of the next Plan year. In most instances awards will be calculated using the participant's union status, base salary and employment status in effect as of December 31st of the Plan year. See *Exceptions to Eligibility and Circumstances for Proration* for details. Overtime earnings are not included in the calculation.

Administration of Plan: The Executive Council is responsible for administering the Plan and may delegate specific administrative tasks to corporate staff, as appropriate.

The Executive Council has the authority to:

- Terminate, amend or modify this Plan in whole or in part for any reason at any time without prior notice to participants
- Modify or adjust the financial targets due to extraordinary occurrences and/or significant reorganizations

Participation in this Plan should in no way be construed as a contract or promise of employment and/or compensation.

Exceptions to Eligibility and Circumstances for Proration

Proration: Proration is determined by the change of status (COS) date. The employee will receive a full month of service no matter what day of the month the COS date occurs. If the COS date is the 5th or the 28th, the employee would receive credit for the full month. For example, an employee who is hired on February 28th and remains employed throughout the Plan year would be eligible for 11 months of their award.

New Hires: Employees hired on or after October 1st will not be eligible for an award under this Plan. No proration is applied to awards if hired during the month of January of the Plan year. Employees hired after January will be eligible to receive awards on a prorated basis.

Regular Scheduled Part-time Employees: Part-time employees will be eligible to receive awards on a prorated basis, based on the normal scheduled hours set up in the payroll system as of December 31st.

Temporary Employees: Temporary employees on a long-term (> 6mo) assignment and that have at least 6 full months of active service will be eligible to receive awards on a prorated basis based on the date of hire. Temporary employees on short-term (< 6mo) assignments are not eligible to participate or receive an award under this Plan.

Seasonal Unemployment/Reemployment: During situations of seasonal unemployment/reemployment, employees will be eligible to receive awards on a prorated

basis based on the number of full months of active service during the Plan year even if the unemployment period is in effect on December 31st.

Leave of Absence: Eligible employees on approved unpaid leave of absence during the Plan year may receive an award on a prorated basis based on the number of full months of active service. *Short-term disability leave is excluded from this provision and may be eligible to receive awards.*

Resignation/Termination: Any employee who resigns or is terminated for reasons other than retirement, disability or death prior to December 31st will not be eligible to receive an award under this Plan. Employees who are eligible for an award and employed as of December 31st but resign or terminate after the Plan year may receive an award at the time of distribution.

Death, Long-term Disability & Retirement: In the case of death, total disability (as defined under the Company's Long-term Disability Plan) or retirement (as defined under the Retirement Plan for Employees), an eligible employee or estate must have at least 6 full months of service within the Plan year to be eligible to receive a prorated award.

Discipline or Poor Performance: Employees who receive a **fails to meet** performance rating for the Plan year or a **Last Chance Agreement** under the Company's formal discipline program as of December 31st are not eligible to receive an award under this Plan.

Transfers between Eligible and Non-eligible Positions or Status: As long as no break in service has occurred and the employee has at least 6 full months of active service in the eligible position or status, the employee may receive a prorated award. The award may be calculated using the status and the base pay as of December 31st or the status and the base pay prior to transfer to non-eligible position or status.

Transfers between Union and Non-union Positions: To receive an award under the non-union opportunity, an employee must have at least 6 full months of active service in a non-union position. Awards will be prorated based on the number of full months of active service in each position. The non-union portion of the award will be calculated using the last recorded base pay and market level for the non-union position held by the union employee.

Transfers from Subsidiaries to Corp/Utilities: Eligible employees who transfer from a subsidiary will be treated as a new hire to the Company and all Plan criteria apply as is.

Other Company Short-term Incentive Plans: Employees can only participate under one formal incentive plan a year. If the employee becomes eligible for a different plan during the year, management has full discretion to determine which plan the employee may receive an award under. Status and/or time in position may be factors considered in determining whether the employee will receive a prorated award from both plans or an award based on the employee's position and/or status as of December 31st.