

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. U-060273

DIRECT TESTIMONY OF

MALYN K. MALQUIST

REPRESENTING AVISTA CORPORATION

**I. INTRODUCTION**

1  
2 **Q. Please state your name, business address, and present position with Avista**  
3 **Corp.**

4 A. My name is Malyn K. Malquist. My business address is 1411 East Mission  
5 Avenue, Spokane, Washington. I am employed by Avista Corp. (Company or Avista) as  
6 Executive Vice President and Chief Financial Officer.

7 **Q. Would you please describe your education and business experience?**

8 A. I received a Bachelors degree and a Master of Business Administration degree  
9 from Brigham Young University. I have also attended a variety of utility finance courses and  
10 leadership programs.

11 I joined Avista Corp. in September of 2002 as Senior Vice President. In November 2002  
12 I was named to the additional position of Chief Financial Officer. In March 2004 the position of  
13 Treasurer was temporarily added until January 2006. Prior to joining Avista, I was General  
14 Manager of Truckee Meadows Water Authority in Reno, Nevada, which was separated out from  
15 Sierra Pacific Power Company in 2001. I was Chief Executive Officer of Data Engines, Inc., a  
16 high tech company located in Reno from June to October of 2000. From April 1994 to April  
17 2000, I was employed by Sierra Pacific Resources, first as the company's chief financial officer  
18 and later as its chairman of the board and chief executive officer. Following the merger of Sierra  
19 Pacific Resources with Nevada Power Company in 1999, I became the President of both Sierra  
20 Pacific Power Company and Nevada Power Company. For the sixteen-year period up to 1994, I  
21 was employed by San Diego Gas & Electric Company in various positions, including Treasurer  
22 and Vice President – Finance.

1           **Q.     What is the scope of your testimony in this proceeding?**

2           A.    I will discuss Avista’s current business operations, and how the proposed  
3 reorganization to a holding company structure provides protection for ratepayers by “ring  
4 fencing” utility operations from the Company’s other non-regulated businesses. This  
5 reorganization would allow Avista to continue to operate its regulated utility business efficiently,  
6 while effecting the legal separation of its non-regulated businesses from its regulated utility  
7 business. Avista Utilities would continue to have a financial and capital structure of its own, its  
8 own debt securities and preferred stock, lines of credit, sources of revenue, operations, and its  
9 own employees. Lastly, I will discuss the Plan of Share Exchange approved by the Board of  
10 Directors to create the holding company.

11           **Q.     Are you sponsoring any exhibits to be introduced in this proceeding?**

12           A.    Yes. I am sponsoring Exhibit No. \_\_\_(MKM-2), which illustrates Avista’s current  
13 Company organization charts for both Avista Corporation and Avista Capital, and Exhibit  
14 No. \_\_\_(MKM-3), which provides a copy of the Plan of Exchange .

15           **Q.     Please describe Avista’s current business operations.**

16           A.    Avista Corporation is an energy company engaged in the generation, transmission  
17 and distribution of energy and, through its subsidiaries, other energy-related businesses.  
18 Avista’s businesses are divided into four segments, as follows:

- 19           • Avista Utilities is an operating division of Avista Corporation that provides  
20 generation, transmission and distribution of electric energy and distribution of natural  
21 gas to retail customers, as well as wholesale purchases and sales of electric capacity  
22 and energy. Avista Utilities provides service to approximately 338,000 electric

1 customers and 205,000 natural gas customers in a 26,000-square-mile area in eastern  
2 Washington and northern Idaho. The largest community served in the area is  
3 Spokane, Washington, which is the location of the corporate headquarters. Avista  
4 Utilities also serves 92,400 natural gas customers in Oregon.

5  
6 Avista Capital, Inc., is a wholly-owned subsidiary of Avista Corporation, and is the  
7 parent corporation of Avista Corporation's non-regulated subsidiary investments and  
8 operations<sup>1</sup>, which includes the remaining three segments as described below.

- 9 • Energy Marketing and Resource Management is a segment which provides electricity  
10 and natural gas marketing, trading and resource management. This business segment  
11 is conducted primarily by Avista Energy, Inc., an electricity and natural gas  
12 marketing, trading and resource management business, operating primarily in the  
13 Western Electricity Coordinating Council (WECC) geographical area, which is  
14 comprised of eleven Western states and the provinces of British Columbia and  
15 Alberta, Canada.
- 16 • Advantage IQ is a segment which provides information and cost management services  
17 for multi-site customers throughout North America. Its primary product lines include  
18 consolidated billing, resource accounting, energy analysis and load profiling services.

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<sup>1</sup> The only exceptions relate to Avista Receivables, Inc., a special purpose subsidiary formed in connection with the sale of accounts receivable, and Spokane Energy, LLC, which was formed for the purpose of implementing a long-term capacity contract between Avista Utilities and Portland General Electric Company. At present, these entities are directly owned by Avista Corporation.



1 Directors of Avista Corporation (Avista Utilities) and the Parent Company. (The Parent  
2 Company is referred to as “AVA Formation Corp.” in the Plan of Exchange.) AVA was  
3 incorporated in the State of Washington on February 10, 2006.

4 Under the terms of the Plan of Exchange, AVA would issue common stock in the same  
5 number of shares as there are shares of Avista Corporation common stock outstanding. Each  
6 share of Avista Corporation common stock would then be exchanged for one share of common  
7 stock in AVA, except to the extent that any holders of Avista Corporation common stock are  
8 entitled to dissent to the proposed transaction and receive payment of their shares pursuant to  
9 such dissenter’s rights. After the share exchange is completed, the Parent Company would own  
10 all the common stock of Avista Corporation and the former holders of the common stock of  
11 Avista Corporation would hold the common stock of the Parent Company. The outstanding first  
12 mortgage bonds, unsecured debt and preferred stock, and all other contracts and agreements to  
13 which Avista is a party, would remain with Avista Utilities. A copy of the Plan of Exchange is  
14 attached as Exhibit No. \_\_\_\_ (MKM-3).

15 **Q. How are Avista’s subsidiaries affected by the Plan of Share Exchange?**

16 A. Avista Capital, Inc. is a wholly owned subsidiary of Avista Corporation, which  
17 holds the stock of Avista Corporation’s non-regulated affiliate investments. In conjunction with  
18 the Reorganization, ownership of Avista Capital, Inc. would be transferred from Avista  
19 Corporation to the Parent Company.<sup>2</sup>

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<sup>2</sup> The dividend of Avista Capital to the Parent Company will not occur until June 1, 2008 when the 9.75% Senior Notes mature, unless consent is received prior to that time.

1 **III. RATEPAYER PROTECTION**

2 **Q. Please summarize some of the overall benefits of the reorganization.**

3 A. Avista believes that the holding company structure would facilitate the protection  
4 of its utility business and customers from its non-utility businesses. The benefits of a holding  
5 company structure may be generally summarized as follows:

- 6
- 7 • Avista's utility operations would be better separated from the non-utility  
8 businesses, making cross subsidization easier to avoid and further ensuring  
9 that non-utility business risk would not affect utility operations.
  - 10 • The new structure would provide better legal protection for Avista Utilities  
11 from liabilities arising from other segments of Avista's business.
  - 12 • The new structure would permit investors, analysts, and rating agencies to  
13 more easily analyze and value the individual lines of business.
  - 14 • Capital structures and financing techniques may be used that are better  
15 suited to the particular requirements, characteristics, and risks of the utility  
16 and non-utility businesses. Such structures and techniques should increase  
17 financial flexibility without adversely affecting the capital structure or  
18 creditworthiness of the utility and non-utility businesses.  
19  
20  
21

22 **Q. Please describe how the proposed Reorganization provides protection for**  
23 **ratepayers by "ring fencing" utility operations from the Company's other non-regulated**  
24 **businesses.**

25 A. The Reorganization to a holding company structure would allow Avista (as Avista  
26 Utilities) to continue to operate its regulated utility business efficiently while effecting the legal  
27 separation of certain non-regulated businesses of Avista from regulated utility businesses.<sup>3</sup>

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<sup>3</sup> Following completion of the Plan of Exchange, by which Avista Corporation would become a subsidiary of the new holding company (AVA), the shares of stock of Avista Capital held currently by Avista Corporation would be distributed to AVA, and Avista Corporation's name would be changed to Avista Utilities, (following the maturity of the 9.75% Senior Notes on June 1, 2008 unless consent is received prior).

1 Avista Utilities would continue to have a financial and capital structure of its own, and would  
2 continue to issue its own debt securities and preferred stock. It would also continue to have its  
3 own lines of credit, sources of revenue, operations, and employees.

4 **Q. How does “ring fencing” the utility operations provide legal separation**  
5 **between the regulated and non-regulated businesses?**

6 A. Avista’s current corporate structure cannot accommodate the same degree of  
7 financial and legal separation as can a holding company structure. All business activities now  
8 must be either part of Avista itself or conducted in entities owned by Avista. As a result, any  
9 volatility in earnings associated with these other businesses will continue to be reflected in  
10 Avista’s financial results. In a holding company structure, these other businesses are expected to  
11 be conducted as holding company subsidiaries separate from Avista. Avista Utilities’ earnings  
12 would be insulated from the potential volatility of these businesses because their activities would  
13 not be reflected in the utility’s financial statements.

14 Avista, as Avista Utilities, would continue to be a separate legal entity and would be  
15 managed as such, separate and distinct from AVA and other AVA subsidiaries (please see  
16 Exhibit No. \_\_\_(KON-2)), which illustrates Avista’s organization structure before and after the  
17 formation of a holding company). The Avista Utilities board of directors would continue to be  
18 an active board that will act in good faith with the care and loyalty expected of a board. Even  
19 though the members of the Avista Utilities board of directors may also be members of AVA’s  
20 board, the two boards will exercise separate and independent functions and duties.

21 **Q. How would the Company’s current cash management procedures be**  
22 **affected by any proposed “ring fencing” of the Utility after the Reorganization?**



1           A.     Avista's current cash management procedures are designed to maintain  
2 segregation between the utility's cash flows and the cash flows of subsidiaries. These cash  
3 management guidelines have been filed with FERC pursuant to Docket No. RM02-14 and are in  
4 compliance with FERC requirements. Each company maintains separate bank accounts and our  
5 cash management guidelines are designed to prevent the commingling of funds. It is Avista's  
6 intention that when the holding company structure becomes effective, AVA will continue to  
7 maintain such separation, after reflecting the impact of the Reorganization.

8           **Q.     How would the Company's current financing procedures be affected by the**  
9 **Reorganization?**

10          A.     Avista Utilities currently issues, and will continue to issue upon completion of the  
11 Reorganization, its own debt and preferred stock, and would maintain its own credit facility for  
12 short-term funding needs. To issue such securities, Avista Utilities will continue to file for  
13 authorization from the commission for such issuances. Avista Utilities common stock will be  
14 solely owned by AVA. When AVA issues stock or debt securities, it would use the proceeds to  
15 fund, as necessary, the common equity requirements of all of its subsidiaries, including Avista  
16 Utilities. The other funding requirements of the non-regulated subsidiaries would be provided by  
17 their own cash flows or separate financing raised at the subsidiary level.

18          Each company will be responsible to pay for its liabilities from its own bank account and  
19 for the funding of its own obligations, either through the issuance of debt or, as appropriate, by  
20 funding from the holding company. Avista Utilities and AVA will each maintain separate credit  
21 ratings, as appropriate. As required by generally accepted accounting principles, liabilities of  
22 each company will continue to be recorded on the books and records of such individual company.



1 Avista's remaining subsidiaries are adequately funded. Avista has downsized its Energy  
2 Marketing and Resource Management business conducted at Avista Energy, as compared to prior  
3 years, and is increasing its focus on the generally lower risk activities related to resource  
4 management and energy services to industrial and large end use customers. And importantly,  
5 Avista has separate, very disciplined, risk management programs in place at both Avista Utilities  
6 and Avista Energy.

7

8 **Q. Does that conclude your pre-filed direct testimony?**

9 A. Yes it does.

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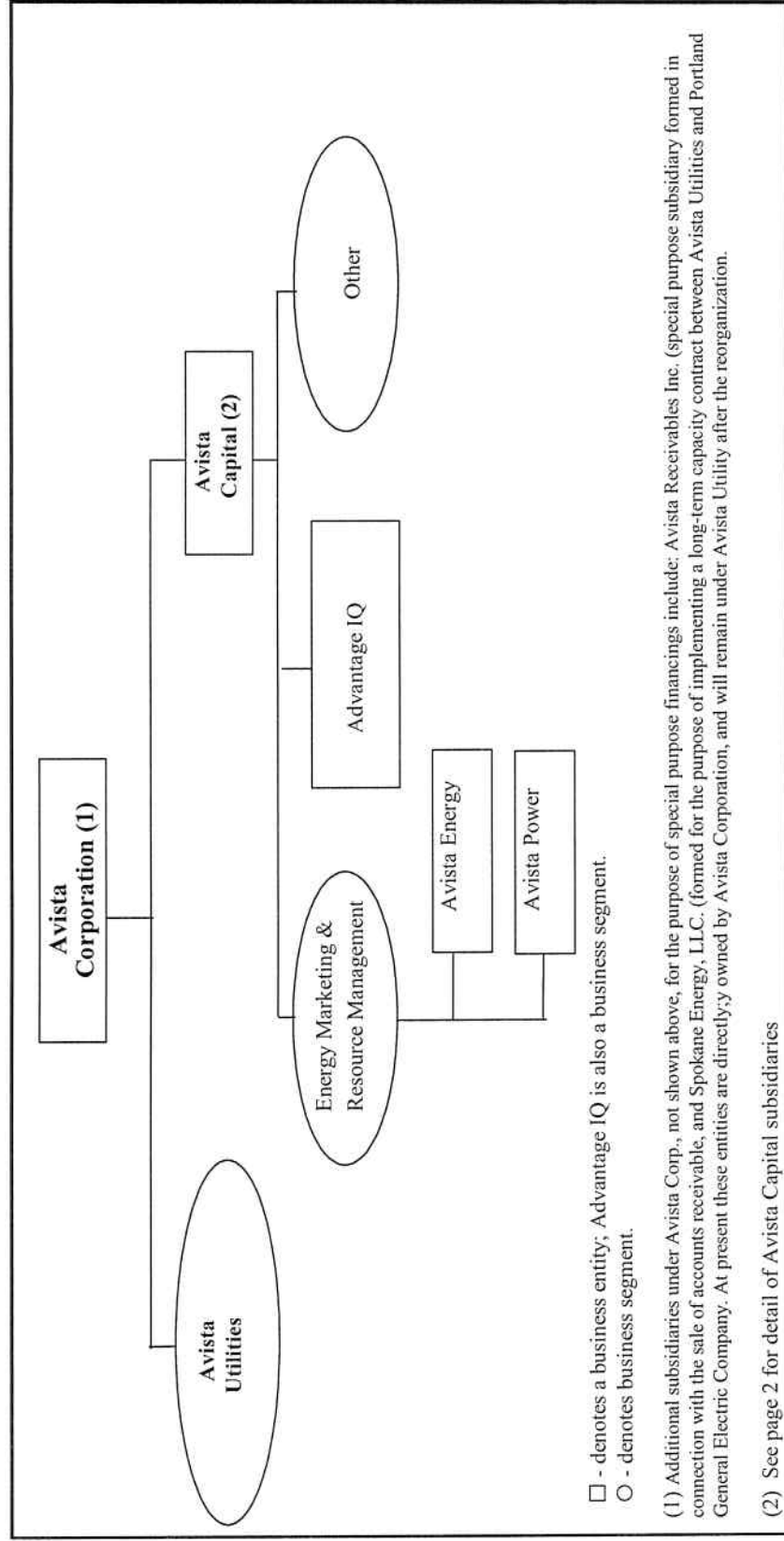
DOCKET NO. UE-060273

EXHIBIT NO. \_\_\_\_ (MKM-2)

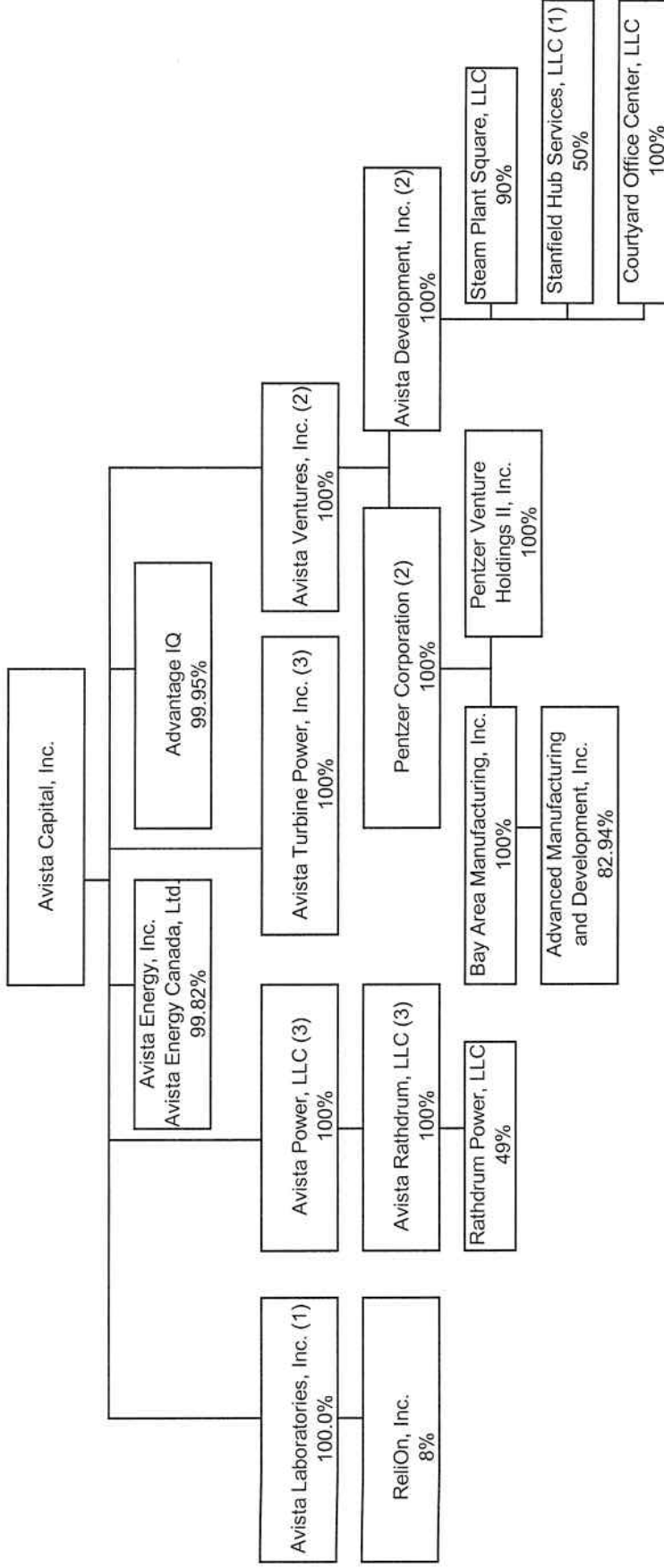
MALYN K. MALQUIST

REPRESENTING AVISTA CORPORATION

# Avista Corporation Organizational Structure September 2006



**Avista Capital Organizational Structure  
September 2006**



(1) Inactive -see note a) below  
 (2) No employees, passive income  
 (3) Ceased active development of additional projects  
 note a) Other Inactive Subsidiaries under Avista Capital, not shown above, include: Coyote Springs 2, LLC

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EXHIBIT NO. \_\_\_\_ (MKM-3)

MALYN K. MALQUIST

REPRESENTING AVISTA CORPORATION

PLAN OF SHARE EXCHANGE

THIS PLAN OF SHARE EXCHANGE (the “**Plan of Exchange**”), dated as of February 13, 2006, is between Avista Corporation, a Washington corporation (“**Avista**”), the corporation whose shares of common stock will be acquired pursuant to the exchange provided for in this Plan of Exchange (the “**Exchange**”), and AVA Formation Corp., a Washington corporation (“**AVA**”), the acquiring corporation. Avista and AVA, together, are referred to in this Plan of Exchange as the “**Companies**.”

RECITALS:

A. The authorized capital of Avista consists of (a) 200,000,000 shares of common stock, without nominal or par value (“**Avista Common Stock**”), of which 48,593,873 shares were issued and outstanding as of January 15, 2006, and (b) 10,000,000 shares of preferred stock, without nominal or par value (“**Avista Preferred Stock**”), of which 262,500 shares were issued and outstanding as of December 31, 2005. The number of issued and outstanding shares of Avista Common Stock is subject to increase to the extent that additional shares are issued prior to the Effective Time (as defined below).

B. AVA is a wholly-owned subsidiary of Avista, with authorized capital of (a) 200,000,000 common shares, without nominal or par value (“**AVA Common Stock**”), of which one hundred (100) shares are issued and outstanding and owned by Avista, and (b) 10,000,000 preferred shares, without nominal or par value, none of which are issued.

C. The Boards of Directors of the Companies deem it desirable and in the best interests of the Companies and the shareholders of Avista that, at the Effective Time, each share of Avista Common Stock be exchanged for one share of AVA Common Stock, with the result that AVA becomes the owner of all outstanding shares of Avista Common Stock and that each holder of shares of Avista Common Stock shall automatically become the holder of an identical number of shares of AVA Common Stock, all on the terms and subject to the conditions set forth below.

D. The Boards of Directors of the Companies have each adopted this Plan of Exchange. The Board of Directors of Avista has voted Avista’s shares of AVA Common Stock to approve, and recommended that the shareholders of Avista approve, this Plan of Exchange pursuant to the Washington Business Corporation Act, Title 23B, Revised Code of Washington, as amended (the “**Act**”), and specifically Section 23B.11.030 of the Act.

NOW, THEREFORE, the Companies agree as follows:

ARTICLE I

This Plan of Exchange shall be submitted to the holders of Avista Common Stock for approval as provided by Section 23B.11.030 of the Act. The affirmative vote of at least two-thirds ( 2/3 ) of the outstanding shares of Avista Common Stock shall be necessary to approve the Plan of Exchange.

ARTICLE II

Subject to the terms and conditions of this Plan of Exchange, the Exchange shall become effective immediately following the close of business on the date of filing with the Secretary of State of the State of Washington (the “**Secretary of State**”) of articles of share exchange pursuant to Section



23B.11.050 of the Act (the “Articles”), or at such later time and date as may be stated in the Articles (the time and date at and on which the Exchange becomes effective, the “Effective Time”).

### ARTICLE III

#### A. At the Effective Time:

(1) Each share of Avista Common Stock issued and outstanding immediately prior to the Effective Time shall be automatically exchanged for one share of AVA Common Stock, which share shall be fully paid and nonassessable.

(2) AVA shall acquire and become the owner and holder of each issued and outstanding share of Avista Common Stock so exchanged.

(3) Each share of AVA Common Stock issued and outstanding immediately prior to the Effective Time shall be canceled and shall constitute an authorized but unissued share of AVA Common Stock.

(4) Each right to receive shares of Avista Common Stock and each unexpired and unexercised option to purchase shares of Avista Common Stock (each, an “Avista Grant”) under an Avista executive compensation or employee benefit plan (each, an “Avista Plan”), whether vested or unvested, shall, pursuant to an amendment to each such Avista Plan, become the right to receive an equal number of shares of AVA Common Stock or an option to purchase, at the same price per share specified in such Avista Grant, that number of shares of AVA Common Stock equal to the number of shares of Avista Common Stock that could have been purchased immediately prior to the Effective Time (assuming full vesting), as the case may be, under the Avista Plans. Each Avista Grant shall be subject to the same terms and conditions as are set forth in the Avista Plans.

(5) Each share of Avista Common Stock held under the Avista Direct Stock Purchase and Dividend Reinvestment Plan (the “Dividend Reinvestment Plan”) immediately prior to the Effective Time shall automatically be exchanged for an equal number (including fractional and uncertificated shares) of shares of AVA Common Stock, and shall continue to be held under the Dividend Reinvestment Plan.

B. Each former holder of shares of Avista Common Stock shall be entitled to receive only (1) shares of AVA Common Stock in exchange for such Avista Common Stock as provided in this Plan of Exchange or (2) payment of the fair value of such shares of Avista Common Stock under Chapter 23B.13 of the Act.

C. As of the Effective Time, AVA shall adopt any of the Avista Plans as in effect immediately prior to the Effective Time under which Avista Grants are outstanding or that continues to provide for new Avista Grants. The Avista Plans shall be appropriately amended to provide for the issuance and delivery of AVA Common Stock on and after the Effective Time on substantially the same terms as Avista Common Stock would have been issuable thereunder immediately prior to the Effective Time.

D. As of the Effective Time, AVA shall succeed to the Dividend Reinvestment Plan as in effect immediately prior to the Effective Time, and the Dividend Reinvestment Plan shall be appropriately amended to provide for the issuance and delivery of AVA Common Stock on and after the Effective Time.

E. As of the Effective Time, each and every preferred share purchase right granted pursuant to the Rights Agreement, dated as of November 15, 1999, between Avista and the Bank of New York as successor Rights Agent, as amended, shall expire and no further rights shall be granted.

#### ARTICLE IV

The filing of the Articles with the Secretary of State and the consummation of the Exchange are subject to satisfaction of each of the following conditions precedent:

A. The approval by the holders of Avista Common Stock provided for in Article I of this Plan of Exchange;

B. the receipt of such orders, authorizations, approvals, waivers or disclaimers of jurisdiction from the Washington Utilities and Transportation Commission, the Idaho Public Utility Commission, the Montana Public Service Commission, the Oregon Public Utility Commission, the Federal Energy Regulatory Commission, and all other regulatory bodies, boards or agencies as are or may be required in connection with the Exchange and related transactions, which orders, authorizations, approvals, waivers and disclaimers shall remain in full force and effect, and shall not include, in the sole judgment of the Board of Director of Avista, unacceptable conditions;

C. the effectiveness of a registration statement under the Securities Act of 1933, as amended, relating to AVA Common Stock to be issued in the Exchange;

D. the approval by the New York Stock Exchange for the listing of the AVA Common Stock to be issued in the Exchange; and

E. the receipt by Avista of a favorable opinion of Heller Ehrman LLP covering certain United States federal income tax matters.

#### ARTICLE V

Following the Effective Time, each holder of an outstanding certificate or certificates that represented shares of Avista Common Stock immediately prior to the Effective Time may, but shall not be required to, surrender such certificates to AVA's transfer agent for cancellation and reissuance of a new certificate or certificates in such holder's name or for cancellation and transfer, and each such holder or transferee shall be entitled to receive a certificate or certificates representing the same number of shares of AVA Common Stock as the shares of Avista Common Stock previously represented by the certificate or certificates surrendered. Until so surrendered or presented for exchange or transfer, each outstanding certificate that, immediately prior to the Effective Time, represented Avista Common Stock shall be deemed and shall be treated for all purposes to represent the ownership of the same number of shares of AVA Common Stock as though such surrender or exchange or transfer had taken place. The holders of Avista Common Stock at the Effective Time shall have no right at and after the Effective Time to have any shares of Avista Common Stock transferred on the stock transfer books of Avista (such stock transfer books being deemed closed for this purpose at the Effective Time), and each record of a holder of outstanding certificate(s) that represented shares of Avista Common Stock immediately prior to the Effective Time shall be recorded as representing the ownership by such holder of the same number of shares of AVA Common Stock in the stock transfer books of AVA at the Effective Time.

ARTICLE VI

A. This Plan of Exchange may be amended, modified or supplemented, or compliance with any provision of this Plan of Exchange may be waived, at any time prior to the Effective Time (including, without limitation, after receipt of the affirmative vote of holders of Avista Common Stock as provided in Article I above), by the mutual consent of the Boards of Directors of Avista and AVA, so long as such amendment, modification, supplement or waiver would not, in the sole judgment of the Board of Directors of Avista, materially and adversely affect the shareholders of Avista.

B. This Plan of Exchange may be terminated and the Exchange and related transactions abandoned at any time prior to the Effective Time (including, without limitation, after receipt of the affirmative vote of holders of Avista Common Stock as provided in Article I above), if the Board of Directors of Avista determines, in its sole judgment, that consummation of the Exchange would for any reason be inadvisable or not in the best interests of Avista or its shareholders.

EXECUTED by each of the Companies, pursuant to authorization and approval given by its Board of Directors, as of the date first above written.

AVISTA CORPORATION

AVA FORMATION CORP.

By: /s/ Gary G. Ely  
Gary G. Ely  
Its Chairman, President & CEO

By: /s/ Gary G. Ely  
Gary G. Ely  
Its President