

**BEFORE THE WASHINGTON STATE  
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Application of	)	DOCKET U-060273
	)	
AVISTA CORPORATION D/B/A	)	ORDER 03
AVISTA UTILITIES,	)	
	)	
for an Order Approving a Corporate	)	ORDER ACCEPTING SETTLEMENT
Reorganization To Create a Holding	)	STIPULATION AND APPROVING
Company, AVA Formation Corp.	)	CORPORATE REORGANIZATION
	)	TO CREATE A HOLDING
	)	COMPANY
	)	
.....	)	

1 *Synopsis: The Commission accepts the multiparty Settlement Stipulation as being in the public interest and approves the corporate reorganization to create a holding company.*

**MEMORANDUM**

**I. Background and Procedural History**

2 On February 16, 2006, Avista Corporation d/b/a Avista Utilities (Avista) filed a request for an Order Approving a Corporate Reorganization to Create a Holding Company, AVA Formation Corp. (AVA).

3 The Washington Utilities and Transportation Commission (Commission) conducted a prehearing conference on September 6, 2006, in Seattle, Washington, before Administrative Law Judges C. Robert Wallis and Patricia Clark. This matter was subsequently assigned to Judge Clark. In Order 01, Prehearing Conference Order, the Commission established a procedural schedule setting deadlines for the submission of prefiled testimony and an evidentiary hearing and granted petitions to intervene filed by Industrial Customers of the Northwest (ICNU) and Northwest Industrial Gas Users

(NWIGU).<sup>1</sup> On October 20, 2006, Avista timely submitted its direct case consisting of the prefiled testimony and exhibits of three witnesses in support of its request.

4 On January 5, 2007, Avista, the Commission's regulatory staff (Staff)<sup>2</sup>, and the Public Counsel Section of the Washington Office of Attorney General (Public Counsel) filed a Settlement Stipulation and supporting narrative. The remaining two parties to this proceeding, ICNU and NWIGU are not signatories to the Settlement Stipulation and neither support nor oppose the settlement. A copy of the Settlement Stipulation is attached to this Order as Appendix A and, by this reference, incorporated herein.

5 The stipulating parties also filed a request to suspend the current procedural schedule in advance of the pending deadline to submit responsive testimony. The Administrative Law Judge issued a procedural order suspending the remainder of the procedural schedule and allowing the parties to submit a position statement regarding whether the Commission should convene an oral hearing or whether this matter could be heard on the written record. Staff filed a position statement on behalf of all stipulating parties stating that they believed the Commission could hear this matter on the basis of the written record unless there is Commission inquiry.

6 **Procedural Matters:** We grant the request of the stipulating parties to admit into evidence the prefiled testimony and exhibits of Avista. We admit into evidence an exhibit list identifying each document as well as the prefiled direct testimony and exhibits submitted by Avista.<sup>3</sup>

7 According to WAC 480-07-740(2), parties to a settlement agreement must file supporting documentation demonstrating that the proposal is consistent with law and the public interest and that it is appropriate for adoption. The supporting documentation should include a narrative, a statement of the parties' views about why the proposal satisfies their interests and the public interest, a summary of the legal points that bear on the proposed settlement, and testimony in support of the proposal.<sup>4</sup>

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<sup>1</sup> NWIGU's petition to intervene was deemed granted absent an objection showing cause for denial. No party filed an objection to the petition.

<sup>2</sup> In formal proceedings, such as this case, the Commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as any other party to the proceedings. There is an "*ex parte* wall" separating the Commissioners, the presiding ALJ, and the commissioners' policy and accounting advisors from all parties, including Staff. *RCW 34.05.455*.

<sup>3</sup> The exhibit list is received as Exhibit No. 1.

<sup>4</sup> WAC 480-07-740(2)(a) and (b).

The settlement stipulation and supporting documentation complies with the requirements of the regulation.

- 8 **Party Representatives:** David J. Meyer, Vice President and Chief Counsel, Spokane, Washington, represents Avista. Donald Trotter, Senior Assistant Attorney General, Olympia, Washington, represents Commission Staff. Judith Krebs, Assistant Attorney General, Seattle, Washington, represents Public Counsel. Matthew Perkins, Davison Van Cleve, Portland, Oregon, represents the ICNU. Edward A. Finklea, Cable Huston Benedict Haagensen & Lloyd, Portland, Oregon, represents NWIGU.

## II. Discussion and Decision

- 9 **Terms of the Settlement Stipulation:**<sup>5</sup> Under the current corporate structure, Avista Corporation d/b/a Avista Utilities is a utility offering electric and/or natural gas service in eastern Washington, northern Idaho, Oregon, and Montana<sup>6</sup>. Avista Capital, the parent corporation of Avista's non-regulated subsidiary investments and operations, is a subsidiary of Avista Corporation.<sup>7</sup>
- 10 Avista proposes to form a holding company, AVA, that would be the parent corporation of Avista and Avista Capital.<sup>8</sup> Avista has comparable cases pending before the Oregon and Montana Commissions; the Idaho Commission and the Federal Energy Regulatory Commission (FERC) have already approved the applications in their jurisdictions.<sup>9</sup> The Settlement Stipulation contains a "most favored nations" clause that would allow the Commission to consider and adopt any terms Avista either agrees to or is required to comply with in other jurisdictions even if the terms are established after entry of an order in Washington.<sup>10</sup>
- 11 Avista would maintain its books and records separate from AVA and the Commission would have access to all books of account, data, and records of both entities as well as information pertaining to transactions between Avista and its affiliated interests.<sup>11</sup> The Commission may audit those records to determine the reasonableness of the

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<sup>5</sup> The terms and conditions in the Settlement Stipulation are, in general, supported by Avista's prefiled direct testimony.

<sup>6</sup> Settlement Stipulation at 2:¶ 6.

<sup>7</sup> *Id.*

<sup>8</sup> Settlement Stipulation at 2-3:¶7.

<sup>9</sup> Settlement Stipulation at 6:¶19.

<sup>10</sup> Settlement Stipulation at 6-8.

<sup>11</sup> Settlement Stipulation, Appendix A at 1:¶1 and ¶2.

allocation factors used to assign costs to Avista.<sup>12</sup> The proposed cost allocation methodology must comply with principles established to ensure that the allocations are reasonable and prudent.<sup>13</sup> An Intercompany Administrative Services Agreement will be developed and filed with the Commission.<sup>14</sup> AVA and Avista commit to use asymmetrical pricing (lower of cost or market for transactions to Avista and higher of cost or marketing for transactions from Avista) if the transaction involves a cost of more than \$100,000.<sup>15</sup>

- 12 Avista and AVA agree to adhere to FERC's Standards of Conduct and FERC's rules governing "shared employees."<sup>16</sup> Avista will maintain separate debt, preferred stock, and corporate credit ratings.<sup>17</sup> In general rate proceedings, Avista agrees to not advocate for a higher cost of capital than would be appropriate absent reorganization.<sup>18</sup> The capital requirements of Avista will be met by AVA and such capital requirements will be given a high priority by the board of directors of AVA and Avista.<sup>19</sup>
- 13 Avista agrees to increase its actual utility equity component to 40 percent by June 30, 2008, and failure to do so will result in use of the actual equity ratio in the next general rate case after that date.<sup>20</sup> Avista will not issue any dividends to AVA if its common equity ratio is below 30 percent Total Adjusted Capital, without Commission approval.<sup>21</sup> If Avista obtains a loan from AVA or any affiliate, in subsequent general rate cases, Avista must demonstrate that the debt obligation interest, terms, and conditions are comparable to or less than market.<sup>22</sup> Avista and AVA will enter into an agreement with ring-fencing provisions that insulate Avista from an AVA bankruptcy.<sup>23</sup>
- 14 The stipulating parties agree that the Commission should admit into evidence the prefiled direct testimony and exhibits filed by Avista.

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<sup>12</sup> Settlement Stipulation, Appendix A at 1:¶5

<sup>13</sup> Settlement Stipulation, Appendix A at 2-3:¶10.

<sup>14</sup> Settlement Stipulation, Appendix A at 2-3:¶10(f).

<sup>15</sup> Settlement Stipulation, Appendix A at 3:¶10(g).

<sup>16</sup> Norwood, Exh. No. 1 at 7:14-16; Settlement Stipulation, Appendix A at 3:¶12.

<sup>17</sup> Settlement Stipulation, Appendix A at 3:¶13,

<sup>18</sup> Settlement Stipulation, Appendix A at 4:¶14

<sup>19</sup> Settlement Stipulation, Appendix A at 4:¶18.

<sup>20</sup> Settlement Stipulation, Appendix A at 4:¶21; Norwood, Exh. No. 3.

<sup>21</sup> Settlement Stipulation, Appendix A at 5:¶22.

<sup>22</sup> Settlement Stipulation, Appendix A at 7:¶33.

<sup>23</sup> Settlement Stipulation, Appendix A at 7:¶34-35.

- 15 **Decision:** According to WAC 480-07-750, we may approve a settlement when doing so is lawful, the terms are supported by an appropriate record, and when the result is consistent with the public interest. We agree with the parties that it is in the public interest to approve and adopt the Settlement Stipulation as our full resolution of the issues pending in this proceeding. We discuss below our reasons for approval and if there are any differences between our discussion and the Settlement Stipulation, the latter controls.
- 16 *Cost of Capital:* Our first concern is whether the proposed corporate structure will adversely impact the public utility's ability to attract capital at reasonable rates. According to the Settlement Stipulation, Avista will maintain separate debt, preferred stock, and corporate credit ratings.
- 17 Avista commits to increase its actual utility equity component to 40 percent by June 30, 2008. If Avista fails to achieve that equity level, it agrees to use its actual equity ratio in the next general rate case. Avista would be subject to a dividend restriction that would prohibit it from issuing dividends, without Commission approval, to AVA if its equity ratio is below 30 percent.
- 18 The proposed corporate structure does not appear to adversely affect, and may improve, Avista's ability to attract capital at reasonable cost and risk. Avista will maintain separate credit ratings which should shield the utility from the vagaries of higher risk non-utility operations.
- 19 *Cross-subsidization:* The reorganization also raises the issue of whether Avista would subsidize non-utility operations under the new corporate structure. To protect against that situation, the Settlement Stipulation requires transactions between Avista and AVA to allocate costs according to reasonable and prudent cost allocation principles. The Intercompany Administrative Services Agreement is essentially a cost allocation manual that must be filed with the Commission. The Commission has the power to audit the books and records of both companies to ensure compliance with cost allocation principles. Avista agrees to asymmetrical pricing which means that the utility ratepayers always achieve the best price for transactions between Avista and AVA.

- 20 We conclude that the cost allocation standards and procedures and asymmetrical pricing provisions coupled with Commission audit provisions, provide sufficient safeguards to ensure that ratepayers do not subsidize non-utility operations.
- 21 *Ring-fencing Provisions:* Ring-fencing provisions are intended to isolate utility operations from any negative financial impacts flowing from unregulated units: (1) to ensure that the utility maintains a strong credit rating and can attract capital; (2) to prevent cross-subsidization of non-regulated ventures; and (3) to ensure regulators' access to timely and accurate information.<sup>24</sup>
- 22 Therefore, the final issue presented by the corporate reorganization is whether Avista is adequately insulated from the operations of the new parent company, AVA, to protect its operations from adverse credit ratings, AVA bankruptcy, and other adverse events attributable to or caused by the parent or an affiliated company. As proposed, Avista will be a separate legal entity.<sup>25</sup> Avista will maintain its own books and records.<sup>26</sup> Within three months of closing the transaction, Avista and AVA will obtain separate corporate credit ratings. If the ring-fencing provisions of the Settlement Stipulation are inadequate to obtain a separate rating, Avista must notify the Commission and propose additional ring-fencing provisions to obtain that separate credit rating.<sup>27</sup> Avista and AVA will enter into an agreement that incorporates the ring-fencing provisions of the settlement and file that agreement with the Commission within three months of closing.<sup>28</sup> In addition, AVA agrees to not acquiesce or seek to include Avista in any AVA bankruptcy so long as Avista is financially healthy.<sup>29</sup> Avista commits to obtain a non-consolidation opinion from an independent law firm finding that the ring-fencing around Avista should be sufficient to prevent Avista from being pulled into an AVA bankruptcy.<sup>30</sup> In addition, the Plan of Share Exchange requires Avista to obtain a favorable opinion from Heller Ehrman LLP covering certain United States federal income tax matters.<sup>31</sup>

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<sup>24</sup> *Mergers and Ring Fencing Issues: An Oregon Perspective*, Oregon Public Utility Commissioner Ray Baum presentation at the Technical Conference on Public Utility Holding Company Act of 2005, December 7, 2006.

<sup>25</sup> Narrative Supporting Settlement at 8 ¶29.

<sup>26</sup> Settlement Stipulation, Appendix A at 1¶1.

<sup>27</sup> Narrative Supporting Settlement at 8 ¶29.

<sup>28</sup> Settlement Stipulation, Appendix A at 7¶34.

<sup>29</sup> Settlement Stipulation, Appendix A at 8¶38.

<sup>30</sup> Settlement Stipulation, Appendix A at 7¶35.

<sup>31</sup> Malquist, Exh. No. 7 at A-3, Article IV(E).

- 23 The ring-fencing provisions in the Settlement Stipulation appear to fulfill the three goals of such provisions. First, Avista would no longer be an operating division; it would be a separate corporation. As a separate corporation, Avista should be better insulated from adverse financial actions of its affiliates than in the current corporate structure. It would have its own credit rating, books and records, and capital structure. Under the reorganization there would be no link between the non-regulated businesses and Avista. Second, as previously discussed, the Settlement Stipulation includes several measures to ensure that there are appropriate cost allocation principles and standards in effect to ensure that Avista will not be subject to cross-subsidization. Third, the Settlement Stipulation specifically provides that the Commission will have access to the books and records of Avista and AVA.
- 24 Moreover, the Commission will have several opportunities to “test” the efficacy of the ring-fencing provisions. First, if Avista and AVA cannot obtain separate credit ratings within three months, they must notify the Commission and propose additional provisions to separate the two entities. Second, the Commission will have the opportunity to review the ring-fencing agreement between AVA and Avista. Third, Avista has committed to obtaining a non-consolidation opinion from an independent law firm. The ring-fencing provisions should ensure that Avista is isolated from negative financial impacts created by AVA or other affiliates.
- 25 Considering the foregoing, we conclude that the terms and conditions of the Settlement Stipulation are consistent with the public interest. Moreover, given the fact that the parties were willing to engage in settlement negotiations before significant time and pecuniary resources were expended in the preparation of prefiled responsive and reply testimony and exhibits and administrative review, both party and Commission resources were conserved. Nonetheless, we specifically reserve the right to invoke the “most-favored nations” clause in the Settlement Stipulation should we conclude that another jurisdiction adopted a provision that we find beneficial and consistent with the public interest in Washington.

### **FINDINGS OF FACT**

- 26 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings of fact and conclusions upon issues and the reasons therefore, the Commission now makes and enters the following summary of those facts, incorporating by reference pertinent portions of the detailed findings:

- 27 (1) Avista Corporation d/b/a Avista Utilities is engaged in the business of  
furnishing electric and gas service within the state of Washington as a public  
service company.
- 28 (2) On February 16, 2006, Avista Corporation d/b/a Avista Utilities filed a request  
for an order approving a corporate reorganization to create a holding company,  
AVA Formation Corp.
- 29 (3) On January 5, 2007, Avista Corporation d/b/a Avista Utilities, the  
Commission's regulatory staff, and the Public Counsel Section of the  
Washington Office of the Attorney General filed a multiparty Settlement  
Stipulation. The remaining two parties to this proceeding, Industrial  
Customers of the Northwest and Northwest Industrial Gas Users are not  
signatories to the Settlement Stipulation and neither support nor oppose the  
settlement.
- 30 (4) The parties to the Settlement Stipulation requested that the prefiled direct  
testimony of Avista Corporation d/b/a Avista Utilities be received in evidence.

**CONCLUSIONS OF LAW**

- 31 Having discussed above all matters material to this decision, and having stated  
detailed findings, conclusions, and the reasons therefore, the Commission now makes  
the following summary conclusions of law, incorporating by reference pertinent  
portions of the preceding detailed conclusions:
- 32 (1) The Washington Utilities and Transportation Commission has jurisdiction over  
the subject matter of, and parties to, this proceeding.
- 33 (2) The prefiled direct testimony and exhibits of Avista Corporation d/b/a Avista  
Utilities should be received in evidence.
- 34 (3) The Settlement Stipulation and accompanying documents comply with the  
requirements of WAC 480-07-740(2).



- 35 (4) The multiparty Settlement Stipulation meets the standard in WAC 480-07-750; it is lawful, it is supported by an adequate record, and is consistent with the public interest and should be accepted.
- 36 (5) Subject to the conditions of the multiparty Settlement Stipulation, the proposed corporate reorganization to create a holding company, AVA Formation Corp., is consistent with the public interest and should be approved.

**ORDER**

THE COMMISSION ORDERS THAT:

- 37 (1) The multiparty Settlement Stipulation filed by Avista Corporation d/b/a Avista Utilities, the Commission's regulatory staff, and the Public Counsel Section of the Washington Office of the Attorney General on January 5, 2007, is accepted.
- 38 (2) Subject to the conditions in the multiparty Settlement Stipulation, the request to create a holding company, AVA Formation, Corp., is approved.
- 39 (3) The request to receive in evidence the prefiled direct testimony and exhibits of Avista Corporation d/b/a Avista Utilities is granted.

DATED at Olympia, Washington, and effective February 28, 2007.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

**NOTICE TO PARTIES:** This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.