

Exhibit No. ___ (APB-2)
Docket No. UE-060181
Witness: Alan P. Buckley

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of

DOCKET NO. UE-060181

AVISTA CORPORATION, d/b/a AVISTA
UTILITIES,

For Continuation of the Company's Energy
Recovery Mechanism, with Certain
Modifications

EXHIBIT TO TESTIMONY OF

ALAN P. BUCKLEY

**STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

April 21, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
 Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005 OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 1-3701

AVISTA CORPORATION

(Exact name of Registrant as specified in its charter)

| | |
|--|---|
| <u>Washington</u> (State or other jurisdiction of incorporation or organization) | <u>91-0462470</u> (I.R.S. Employer Identification No.) |
| <u>1411 East Mission Avenue, Spokane, Washington</u> (Address of principal executive offices) | <u>99202-2600</u> (Zip Code) |
| Registrant's telephone number, including area code: | <u>509-489-0500</u> |
| Web site: http://www.avistacorp.com | |

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of Class</u> | <u>Name of Each Exchange on Which Registered</u> |
|---|---|
| Common Stock, no par value, together with Preferred Share Purchase Rights appurtenant thereto | New York Stock Exchange Pacific Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
Preferred Stock, Cumulative, Without Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes No

The aggregate market value of the Registrant's outstanding Common Stock, no par value (the only class of voting stock), held by non-affiliates is \$902,211,367 based on the last reported sale price thereof on the consolidated tape on June 30, 2005.

As of February 28, 2006, 48,617,354 shares of Registrant's Common Stock, no par value (the only class of common stock), were outstanding.

Documents Incorporated By Reference

| <u>Document</u> | <u>Part of Form 10-K into Which Document is Incorporated</u> |
|--|--|
| Proxy Statement-Prospectus to be filed in connection with the annual meeting of shareholders to be held May 11, 2006 | Part III, Items 10, 11, 12, 13 and 14 |

PART I

This Annual Report on Form 10-K contains forward-looking statements, which should be read with the cautionary statements and important factors included in this Annual Report on Form 10-K at "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements." Forward-looking statements are all statements other than statements of historical fact, including, without limitation, those that are identified by the use of words such as, but not limited to, "will," "may," "could," "should," "intends," "plans," "seeks," "anticipates," "estimates," "expects," "forecasts," "projects," "predicts," and similar expressions. All forward-looking statements are subject to a variety of risks and uncertainties and other factors, most of which are beyond the control of Avista Corporation and many of which could have a significant effect on Avista Corporation's operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements.

Available Information

The Web site address of Avista Corporation (Avista Corp. or the Company) is www.avistacorp.com. Avista Corp. makes available free of charge, on or through its Web site, its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission. Information contained on Avista Corp.'s Web site is not part of this report.

Item 1. Business

Company Overview

Avista Corp., incorporated in the State of Washington in 1889, is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. As of December 31, 2005, the Company employed approximately 1,435 people in its utility operations and approximately 550 people in its subsidiary businesses. The Company's corporate headquarters are in Spokane, Washington, center of the Inland Northwest geographic region. Agriculture, mining and lumber were the primary industries in the Inland Northwest for many years; today health care, education, finance, electronic and other manufacturing, tourism and the service sectors are growing in importance.

The Company has four business segments – Avista Utilities, Energy Marketing and Resource Management, Avista Advantage and Other. Avista Capital, a wholly owned subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility business segments. The Company's total common stockholders' equity was \$771.1 million as of December 31, 2005 of which \$237.7 million represented its investment in Avista Capital.

Avista Utilities is an operating division of Avista Corp. comprising the regulated utility operations that started in 1889. Avista Utilities generates, transmits and distributes electricity and distributes natural gas. Avista Utilities also engages in wholesale purchases and sales of electricity and natural gas. Avista Utilities expects to continue to be among the industry leaders in performance, value and service in its electric and natural gas utility businesses. Based on Avista Utilities' forecast for electric customer growth of 2.5 percent and natural gas customer growth of 4 percent within its service area, Avista Utilities anticipates retail electric and natural gas load growth will average between 3 and 3.5 percent annually for the next four years. As part of Avista Utilities' strategy to focus on its business in the northwestern United States, in April 2005, the Company completed the sale of its natural gas properties in South Lake Tahoe, California (see "Note 28 of the Notes to Consolidated Financial Statements"). This was the Company's only regulated utility operation in California.

The Energy Marketing and Resource Management business segment is comprised of Avista Energy, Inc. (Avista Energy) and Avista Power, LLC (Avista Power). Avista Energy, which commenced operations in 1997, is an electricity and natural gas marketing, trading and resource management business, operating primarily in the Western Electricity Coordinating Council (WECC) geographical area, which is comprised of eleven Western states and the provinces of British Columbia and Alberta, Canada. Avista Energy focuses on optimization of generation assets owned by other entities, long-term electric supply contracts, natural gas storage, and electric transmission and natural gas transportation arrangements. Avista Energy is also involved in trading electricity and natural gas, including derivative commodity instruments. Avista Energy Canada, Ltd. (Avista Energy Canada) is a wholly owned subsidiary of Avista Energy that provides natural gas services to end-user industrial and commercial customers in British Columbia, Canada. In addition to earnings and resulting cash flows from settled or realized transactions, Avista Energy records unrealized or mark-to-market adjustments for the change in the value of derivative commodity instruments. Avista Energy continues to seek opportunities to expand its business of optimizing generation assets

CONSOLIDATED STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

Avista Corporation

For the Years Ended December 31

Dollars in thousands

| | 2005 | 2004 | 2003 |
|---|------------------|------------------|------------------|
| Continuing Operating Activities: | | | |
| Net income..... | \$ 45,168 | \$ 35,154 | \$ 44,504 |
| Loss from discontinued operations..... | - | - | 4,949 |
| Cumulative effect of accounting change..... | - | 460 | 1,190 |
| Purchases of securities held for trading..... | - | (15,260) | (18,865) |
| Sales of securities held for trading..... | - | 34,192 | - |
| Non-cash items included in net income: | | | |
| Depreciation and amortization..... | 86,911 | 78,425 | 77,811 |
| Provision for deferred income taxes..... | 8,865 | 19,168 | 28,395 |
| Power and natural gas cost amortizations, net of deferrals..... | 9,630 | 11,087 | 3,829 |
| Amortization of debt expense..... | 7,762 | 8,301 | 7,972 |
| Write-offs and impairments of assets..... | 1,001 | 21,990 | 4,900 |
| Energy commodity assets and liabilities..... | 38,126 | 678 | 22,128 |
| Gain on sale of utility properties..... | (4,093) | - | - |
| Other..... | (7,367) | 3,770 | (11,214) |
| Changes in working capital components: | | | |
| Sale of customer accounts receivable under revolving agreement-net..... | 13,000 | - | 7,000 |
| Accounts and notes receivable..... | (203,363) | (6,904) | (4,485) |
| Materials and supplies, fuel stock and natural gas stored..... | (10,642) | (4,023) | (682) |
| Deposits with counterparties..... | (28,687) | 6,181 | (1,175) |
| Other current assets..... | (19,801) | (16,283) | (14,076) |
| Accounts payable..... | 189,115 | 26,909 | (41,352) |
| Deposits from counterparties..... | 7,709 | (91,796) | 5,137 |
| Other current liabilities..... | (4,789) | 5,996 | 10,087 |
| Net cash provided by continuing operating activities..... | <u>128,545</u> | <u>118,045</u> | <u>126,053</u> |
| Continuing Investing Activities: | | | |
| Utility property capital expenditures (excluding AFUDC)..... | (213,652) | (115,346) | (102,271) |
| Other capital expenditures..... | (4,044) | (3,126) | (3,388) |
| Deposit for utility property acquisition..... | - | (5,000) | - |
| Decrease (increase) in restricted cash..... | 541 | (9,703) | (3,489) |
| Changes in other property and investments..... | 2,033 | 517 | (5,953) |
| Repayments received on notes receivable..... | 318 | 1,062 | 1,214 |
| Proceeds from property sales..... | 17,211 | 2,466 | 549 |
| Net cash used in continuing investing activities..... | <u>(197,593)</u> | <u>(129,130)</u> | <u>(113,338)</u> |

The Accompanying Notes are an Integral Part of These Statements.

AVISTA CORPORATION

The following table presents information for each of the Company's business segments (dollars in thousands):

| | Avista Utilities | Energy Marketing And Resource Management | Avista Advantage | Other | Intersegment Eliminations (1) | Total |
|---|---------------------|--|---------------------|----------|----------------------------------|-------------|
| For the year ended December 31, 2005: | | | | | | |
| Operating revenues..... | \$1,161,317 | \$167,439 | \$31,748 | \$18,532 | \$ (19,429) | \$1,359,607 |
| Resource costs..... | 669,596 | 165,423 | - | - | (19,429) | 815,590 |
| Gross margin..... | 491,721 | 2,016 | - | - | - | 493,737 |
| Other operating expenses..... | 181,478 | 18,795 | 22,738 | 18,120 | - | 241,131 |
| Depreciation and amortization..... | 80,914 | 1,488 | 2,037 | 2,472 | - | 86,911 |
| Income (loss) from operations..... | 165,378 | (18,267) | 6,973 | (2,060) | - | 152,024 |
| Interest expense (2)..... | 91,847 | 395 | 912 | 1,694 | (2,134) | 92,714 |
| Income taxes..... | 29,967 | (4,981) | 2,147 | (1,272) | - | 25,861 |
| Net income (loss)..... | 52,479 | (8,621) | 3,922 | (2,612) | - | 45,168 |
| Capital expenditures..... | 213,652 | 1,573 | 1,106 | 1,365 | - | 217,696 |
| For the year ended December 31, 2004: | | | | | | |
| Operating revenues..... | 972,574 | 275,646 | 23,444 | 17,127 | (137,211) | 1,151,580 |
| Resource costs..... | 519,002 | 236,804 | - | - | (137,211) | 618,595 |
| Gross margin..... | 453,572 | 38,842 | - | - | - | 492,414 |
| Other operating expenses..... | 180,418 | 25,797 | 19,800 | 21,781 | - | 247,796 |
| Depreciation and amortization..... | 72,787 | 1,364 | 1,902 | 2,372 | - | 78,425 |
| Income (loss) from operations..... | 134,073 | 11,681 | 1,742 | (7,026) | - | 140,470 |
| Interest expense (2)..... | 92,068 | 528 | 874 | 1,008 | (1,431) | 93,047 |
| Income taxes..... | 18,383 | 5,421 | 334 | (2,546) | - | 21,592 |
| Net income (loss) before cumulative effect of accounting change..... | 32,467 | 9,733 | 577 | (7,163) | - | 35,614 |
| Net income (loss)..... | 32,467 | 9,733 | 577 | (7,623) | - | 35,154 |
| Capital expenditures..... | 115,346 | 1,455 | 840 | 831 | - | 118,472 |
| For the year ended December 31, 2003: | | | | | | |
| Operating revenues..... | 928,211 | 307,141 | 19,839 | 13,581 | (145,387) | 1,123,385 |
| Resource costs..... | 483,097 | 246,952 | - | - | (145,387) | 584,662 |
| Gross margin..... | 445,114 | 60,189 | - | - | - | 505,303 |
| Other operating expenses..... | 165,478 | 28,852 | 18,518 | 15,570 | - | 228,418 |
| Depreciation and amortization..... | 72,068 | 1,259 | 2,652 | 1,832 | - | 77,811 |
| Income (loss) from operations..... | 146,777 | 30,078 | (1,331) | (3,821) | - | 171,703 |
| Interest expense (2)..... | 91,908 | 1,009 | 742 | 1,025 | (1,699) | 92,985 |
| Income taxes..... | 26,884 | 11,457 | (718) | (2,283) | - | 35,340 |
| Income (loss) from continuing operations..... | 36,241 | 20,672 | (1,334) | (4,936) | - | 50,643 |
| Capital expenditures..... | 102,271 | 2,013 | 459 | 916 | - | 105,659 |
| Total Assets: | | | | | | |
| Total assets as of December 31, 2005 | 2,838,154 | 2,012,354 | 46,094 | 51,892 | - | 4,948,494 |
| Total assets as of December 31, 2004 | 2,608,155 | 1,002,843 | 47,318 | 53,305 | - | 3,711,621 |

- (1) Intersegment eliminations reported as operating revenues and resource costs represent the transactions between Avista Utilities and Avista Energy for energy commodities and services, primarily natural gas purchased by Avista Utilities under the Agency Agreement. Intersegment eliminations reported as interest expense represent intercompany interest.
- (2) Including interest expense to affiliated trusts.