

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 10, 2007

REGULAR _____ CONSENT X EFFECTIVE DATE _____ NA _____

DATE: June 11, 2007

TO: Public Utility Commission

FROM: Michael Dougherty

THROUGH: Lee Sparling and Marc Hellman

SUBJECT: AVISTA UTILITIES: (Docket No. UI 267) Application of Avista Corporation dba Avista Utilities to Enter into Loans to and from Avista Capital, an Affiliated Interest.

STAFF RECOMMENDATION:

The Public Utility Commission (Commission) should approve the application of Avista Corporation dba Avista Utilities (Avista or Company) for an affiliated interest agreement with Avista Capital subject to the following conditions.

1. The Company shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to loans to and from Avista Capital.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this arrangement in any rate proceeding or earnings review under an alternative form of regulation.
3. The Company shall notify the Commission in advance of any substantive changes to the agreement, including any material changes in any cost or any changes due to the formation of the holding company, AVA Corp. Any changes to the agreement terms that alter the intent and extent of activities under the agreement from those approved herein, shall be submitted for approval in an application for a supplemental order (or other appropriate format) in this docket.
4. Avista shall continue to set the interest rate on funds loaned to Avista Capital, at a rate equal to the Prime rate. Avista shall set the interest rate on funds borrowed from Avista Capital, at Avista's avoided short term cost of borrowing.

5. Short-term notes (less than 12 months) payables from Avista Capital shall not exceed \$40,000,000. Any amount that exceeds this threshold shall require an application for a supplemental order in this docket.
6. Avista shall hold customers harmless and remove the effects of any costs associated with the loans with Avista Capital from rates or any regulatory reporting requirement. Avista shall provide the Commission complete, open access to the full books, documents, data, and records of Avista and Avista Capital regarding this transaction.

DISCUSSION:

This application was filed on May 11, 2007, pursuant to ORS 757.495(5) and OAR 860-027-0030.¹ Avista Capital is a wholly-owned subsidiary of Avista Corp. and therefore, the two entities are affiliated interests pursuant to ORS 757.015.

Avista's application resulted from a recommendation in Staff's Audit Report of Avista Utilities, Audit 2006-002, dated February 16, 2007, that stated:

"Avista should file an affiliated interest application with the Commission for approval of loans to and from affiliates, including Avista Capital within 90 days of this report."

Avista's timely filing of this application complies with Staff's recommendation in the audit report.

As part of Avista's on-going cash management practices and operations, from time to time, Avista makes unsecured short-term loans to, and obtains borrowings from Avista Capital. In turn, Avista Capital from time to time makes unsecured short-term loans to, and obtains borrowings from its subsidiaries. As of December 31, 2006, Avista held a short-term note receivable from Avista Capital in the principal amount of \$7.2 million.

¹ The application references OAR 860-027-0035 as the filing format; however, the Company used the format prescribed in OAR 860-027-0030. Since this application is a request to enter into loans to and from an affiliate, either OAR 860-027-0030 or OAR 860-027-0040 would be the proper format and both rules allow for the inclusion of necessary information to properly examine the application.

The following issues were investigated:

- Scope of the Agreement
- Transfer Pricing
- Determination of Public Interest Compliance
- Records Availability, Audit Provisions, and Reporting Requirements

Scope of the Agreement

There is actually no agreement between Avista and Avista Capital since the loan policy is outlined in Avista's Cash Management Guidelines and Procedures. Staff had previously reviewed this policy during Staff's Audit Report of Avista Utilities, Audit 2006-002, dated February 16, 2007. Staff has again reviewed Avista's Cash Management Guidelines and Procedures and did not observe any unusual conditions in the policy.

According to Avista, if Docket UM 1250, *Avista Corp., Application for an Order Approving a Corporate Reorganization to Create a Holding Company*, is approved by the Commission, the Company anticipates that loans to and from Avista Capital would be between Avista Capital and the holding company, AVA Corp. As a result, Avista Utilities would no longer be a participant in the loan arrangement. However, there could be loans between AVA Corp and Avista Utilities.

Transfer Pricing

Interest on the notes loaned to and borrowed from Avista Capital is accrued in accordance with the Company's Cash Management Guidelines and Procedures. According to the policy:

- a. Upon receiving appropriate approvals, excess Avista Capital cash may be invested with (loaned to) Avista at a rate equal to Avista's avoided short-term borrowing cost, currently estimated at the one-month LIBOR plus 50 basis points. The rate will be reset monthly with the LIBOR rate in effect on the second business day of each month, as reported in the money rate section of the Wall Street Journal.²

² At times, Avista does not have any outstanding cash borrowings under the credit facility. When there are no outstanding cash borrowings under the credit facility, excess cash is utilized to pay down borrowings on the accounts receivable program (ARP). The avoided short-term borrowing rate on the ARP is reset on the 15th of each month. The rate received on excess cash invested with Avista (that is utilized to pay down the ARP borrowings) will be at the ARP rate plus the ARP utilization fee.

- b. Avista Capital may borrow from Avista subject to board-approved limits, at a rate equal to the Prime rate. The rate will be reset at such time as the Agent Bank on the Avista Revolving Credit Agreement changes the Prime rate.

The investment/borrowing rates between Avista and Avista Capital adhere to the Commission's transfer pricing policy pursuant to OAR 860-027-0048, Cost Allocations by an Energy Utility.

Determination of Public Interest Compliance

According to Avista, the Company believes the loans between Avista and Avista Capital allow the organization to efficiently manage cash at the corporate and subsidiary levels, minimize borrowing costs, and maximize investment returns. In addition, the recommended order conditions limit the loan amount, ensure interest rates are in compliance with the Commission's transfer pricing policy, and hold customers harmless from any effects of the loans. As a result, the application is not contrary to the public interest.

Records Availability, Audit Provisions, and Reporting Requirements

Staff Recommendation Conditions No. 1 and No. 6 afford necessary access to any relevant records. In addition, intercompany loans between Avista and Avista Capital are provided in detail in the Company's Annual Affiliated Interest Reports.

Based on the review of this application, Staff concludes the following:

1. The loan arrangement's scope is reasonable.
2. The loan arrangement will not harm customers and is not contrary to the public interest with the recommended conditions.
3. Necessary records are available.

Avista has reviewed Staff's recommendations and does not disagree with the recommendations.

PROPOSED COMMISSION MOTION:

Avista Utilities' affiliated interest agreement with Avista Capital be approved, subject to the recommended conditions.