

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: November 4, 2008**

REGULAR CONSENT EFFECTIVE DATE _____ N/A _____

DATE: October 30, 2008

TO: Public Utility Commission

FROM: Steve Storm

THROUGH: Lee Sparling and Marc Hellman

SUBJECT: AVISTA CORPORATION: (Docket No. UF 4246(1)) Requests amendments to Order No. 08-143 in UF 4246.

STAFF RECOMMENDATION:

The Commission should approve Avista Corporation's (Avista or Company) request for an amendment to Order No. 08-143, in UF 4246, subject to the following conditions and reporting requirements:

- 1) Securities issued under this authority shall not exceed a total of \$550,000,000 or, if the securities are issued at an original issue discount, such greater amount as shall result in an aggregate offering price of not more than \$550,000,000 (or its equivalent amount inclusive of any securities issued under this authority in foreign currencies). The total of securities issued under this authority is to include securities issued under authorization granted in Order No. 08-143.
- 2) The Company shall demonstrate the cost-effectiveness of any early refunding of existing securities and that any put or call provision or required sinking fund placed on new issuances is cost-effective.
- 3) The Commission reserves judgment on the reasonableness for ratemaking purposes of the Company's capital costs, capital structure and the commissions and expenses incurred for security issuances. The Company has the burden of proof to demonstrate that its financing activities; capital costs, including embedded expenses; and capital structure are just and reasonable
- 4) Subsequent to a Commission Order pursuant to this application, Avista may issue the debt securities as set forth in Avista's filings of January 25, 2008 and

October 7, 2008, without further Commission approval if all-in rate¹ spreads do not exceed limits set forth in column C of Table 1 in Attachment A. Alternatively, should all-in rate spreads exceed the relevant maximum all-in rate spread over Treasuries limitation as set forth in column C of Table 1 in Attachment A, the Company may issue debt securities without further Commission approval if the all-in rate does not exceed 10.0 percent. Should issuance be under this alternative, the Company shall provide a post-issuance report to the Commission within ten business days, with the report describing the prevailing market conditions for the Company's debt, explaining the reasons for the high level of spreads over Treasuries relative to the all-in rate, and detailing any steps taken by the Company to minimize the overall cost of the issuance.

- 5) Maturities for debt securities issued under the amended Order issued pursuant to this filing are to range from five- to 31-year maturities, inclusive.
- 6) The authorization is to remain in effect as long as the Company maintains senior secured debt ratings no lower than BBB-/Baa3 (i.e., "investment-grade") from Standard & Poor's and Moody's Investors' Service, Inc., respectively.
- 7) All conditions and reporting requirements associated with Order No. 08-143 continue to apply, except where expressly modified within the amended order issued pursuant to this filing.

DISCUSSION:

The Commission approved Avista's application for authority to issue up to \$350,000,000 of first mortgage bonds (FMBs) in UF 4246, Order No. 08-143, entered on February 29, 2008. Since that time yields on U.S. Treasury bonds have fallen. However, credit spreads over yields on benchmark Treasury securities for prospective Avista bonds have increased such that current spread estimates may now exceed many of the maximum authorized spreads as set forth in Table 1 of Appendix A of Order No. 08-143.

In this filing, Avista requests Order No. 08-143 be amended, with the amount of debt securities authorized in Order No. 08-143, increased from \$350 million to \$550 million. Additionally, Avista requests that any debt securities issued under the amended

¹ The terms "all-in rate" and "all-in cost" used here are defined as including all associated issuance expenses, the coupon rate, and any discount from par value at issuance. Technically, it is the percentage Internal Rate of Return (IRR) when all costs, such as any Original Issue Discount (OID), floatation, and insurance costs, as well as the actual cash flows of the security, are included. See page 747 of "Futures, Options, and Swaps," Fifth Edition; by Robert W. Kolb and James A. Overdahl; Blackwell Publishing, Ltd; 2007.

authorization fall within a maximum coupon rate² of 8.5 percent, or, alternatively, within the maximum spreads over Treasury yields as listed in Table 1 of the Company's October 7, 2008, filing.

Pricing and Expenses

Staff wishes to clarify the order of consideration in determining whether an issuance falls within cost/pricing limitations. The first consideration is: "Will the debt securities be issued having an all-in rate within the maximum spread over the yield of the relevant benchmark Treasury security, as provided in column C of Table 1 in Attachment A?" Should this be the case, the limitation on pricing is considered to be met.

Should this not be the case, a second consideration is addressed: "Will the debt securities be issued having an all-in rate less than or equal to 10.0 percent?" If the second consideration is met, then the limitation on pricing is considered to be met. In other words, the pricing limitation is considered met if, first, the applicable all-in rate spread limitation is met, or alternatively, if the spread limitation is not met while the all-in rate limitation is met.

Staff established the maximum all-in rate spread over the yield of the relevant benchmark Treasury security by calculating all-in rates for five-, 10-, and 30-year maturities based on information supplied by the Company. Subtracting the closing benchmark Treasury yields on October 27, 2008, from the calculated all-in rates provided the all-in rate spread for each of the three maturities. An all-in rate spread weighted average of the three maturities was calculated, with the five- and 10-year maturities receiving weightings of 25 percent each and the 30-year maturity receiving a weighting of 50 percent.

Under the current credit environment, focusing on credit (interest rate) spreads alone may not be sufficient, since high spreads may be offset by relatively low Treasury yields, resulting in moderate to low interest rates on utility debt securities. Since the all-in-rate represents the inclusive borrowing costs to the Company and potentially to its customers, it is reasonable under current conditions to provide an alternative to the traditional spread table included in most utility financing dockets. The provided alternative is intended to afford the Company additional flexibility in issuing debt in the current financial environment, while continuing to provide protections to customers.

As a numerical example, consider the hypothetical situation where Avista issues \$550 million in 30-year first mortgage bonds (FMBs) at par with a coupon rate of 8.5 percent,

² Avista defines maximum coupon rate in the Company's October 7, 2008 letter as the coupon rate plus any discount on the debt securities.

which is 438 basis points (bps) over the October 27, 2008, benchmark U.S. Treasury coupon rate of 4.12 percent. Issuance and other associated costs total \$6.4 million and interest is paid semiannually. The all-in cost of this hypothetical bond issuance is calculated to be 8.609 percent, or 449 bps over the benchmark Treasury. In this example the all-in rate of the FMBs exceeds the maximum credit spread of 440 bps for 30-year securities per Table 1 of Appendix A, but the all-in rate falls within the maximum all-in rate for 30 year securities of 10.0 percent. Therefore Avista could issue the FMBs and be in compliance with Staff's recommended amendment to Order No. 08-143.

Use of Proceeds

Avista represented, in an October 29, 2008, e-mail to Staff, that the purposes for which securities are proposed to be issued are any or all of the following: (1) the Company's construction, facility improvement, and maintenance programs; (2) to retire or exchange one or more outstanding stock, bond, or note issuances; (3) to reimburse the Company's treasury for funds previously expended; and (4) for such other purposes, as may be permitted by law. To the extent the Company's treasury is refunded, the original expenditures, or their precedents, are represented by the Company to have been made for purposes described by ORS 757.415(1)(a), (b), or (e). To the extent that obligations are discharged or refunded, the Company represents those obligations or their precedents were used for purposes described by ORS 757.415(1)(a), (b), or (e). The Company represents that these purposes are believed to be consistent with the public interest and necessary or appropriate for or consistent with the proper performance by the Company of service as a public utility.

These purposes are consistent with statutory requirements and are permitted under ORS 757.415(1).

Based on Staff's review, Avista's requested amendment to Order No. 08-143, as modified in Staff's Report, appears reasonable and meets the appropriate statutory requirements.

PROPOSED COMMISSION MOTION:

Commission Order No. 08-143 be amended by inclusion of Staff's Report of October 30, 2008; with the amended Order increasing Avista's authorization from \$350 million to \$550 million; including the issuance of debt securities having maturities from five- to 31-years, inclusive; and specifying a maximum all-in rate of 10.0 percent over benchmark U.S. Treasury security yields should Avista's debt security issuances under this authority exceed the relevant maximum all-in rate spreads over benchmark U.S. Treasury security yields for various maturities as specified in Table 1 of Attachment A of Staff's October 30, 2008, Report.

Attachment

Attachment A

Interest rates:

The proposed maximum spread over the applicable Treasury security for various maturities is listed below. Interest rates on the Bonds will be determined at issuance.

Table 1

**Maximum Spreads over Benchmark U.S. Treasury Yield³
for Debt Securities**

Maturity:		Maximum Spread:
Greater Than or Equal To	And Less Than	All-in Rate Over Benchmark Treasury Yield
(A)	(B)	(C)
4 years	6 years	+ 430 basis points
6 years	9 years	+ 430 basis points
9 years	10 years	+ 430 basis points
10 years	11 years	+ 430 basis points
11 years	15 years	+ 430 basis points
15 years	20 years	+ 430 basis points
20 years or more		+ 430 basis points

³ The Benchmark U.S. Treasury Yield, with respect to any of the debt securities' maturity range, means the yield to maturity of that issue of direct obligations of the United States which, out of all actively traded issues of such obligations with a remaining term to maturity within such debt securities' maturity range, is generally considered by dealers in such obligations to be the standard for such obligations. With respect to the issuance of any of the debt securities', the Benchmark U.S. Treasury Yield shall be determined as of the time the commitment to purchase such debt securities' is received by the Company or its agents.