ITEM NO. CA1

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: October 6, 2015

REGULAR ___ **CONSENT** X **EFFECTIVE DATE** N/A

DATE: October 2, 2015

TO: Public Utility Commission

FROM: Matt Muldoon *mjm*

THROUGH: Jason Eisdorfer and Marc Hellman

SUBJECT: AVISTA CORPORATION: (Docket No. UF 4294) Requests authority to issue an incremental $300 million of debt securities, and an incremental 1,635,000 shares of common stock through its LTIP.

STAFF RECOMMENDATION:

Staff recommends that the Commission approve Avista Corporation's (Avista or Company) application subject to the following conditions and reporting requirements. The Company has reviewed and agrees with this memo.

1. Authorization Limits

   Debt Securities: Total debt securities issued, sold or exchanged under this authority shall not exceed $435 million,[1] inclusive of any Original Issue Discount (OID). Maturities for debt securities may not exceed 40 years.

   Long Term Incentive Plan (LTIP): Total stock, with no par value issued, sold or exchanged under this authority through the Company's LTIP shall not exceed 2,021,360 common shares.

   Exception: If all currently awarded shares do not become fully vested or otherwise meet all transfer criteria, such shares will be returned to available-to-award status in the LTIP. In that case, total stock available to award shall not exceed 3,155,348 Common Shares.[2]

2. Withdrawal of Prior Authorizations

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1 In a letter dated October 1, 2015, Avista provided updated issuance quantities. $300 million debt securities issuance plus Avista's outstanding $135 million authority results in $435 million total aggregate authority, $15 million less than authorized by Commission Order No. 11-334.

2 Avista's update for October 1 also clarifies that maximum shares potentially available for LTIP award would be: 1,635,000 newly authorized shares plus 386,360 shares available to award plus 1,133,988 shares awarded from 2013 through 2015 that may not meet all vesting and other requirements.

Commission's issuance authorizations listed below will automatically terminate upon the issuance of a Commission Order in UF 4294.

Type	Order No.	Docket No.	Unused Authorization
LT Debt	11-334	UF 4269	$135 million
LTIP	12-004	UF 4271(1)	386,360 shares

3. Cost Requirements

Debt Securities: The Company shall demonstrate for all issuances and associated activities that the Company achieved cost effective All-in Rates. Subsequent to an authorizing Commission order pursuant to this application, the Company may issue Debt Securities without further Commission approval provided either:

A. Agent and underwriting commissions, and spread(s) over yield(s) on like maturity UST for fixed-rate Debt Securities do not exceed limits set forth in Attachment A. Interest rates on floating rate Debt Securities may be periodically reset based on a spread over 1-, 2-, 3-, or 6-month London Interbank Offering Rates (LIBOR) or other customary floating rate sources. The Company will maintain records to show that spreads over a common benchmark were competitive. In the unlikely event that LIBOR is not reported or is unavailable, the Company may use a rate from another recognized customary source intended for floating rate debt.

B. The Company may issue fixed-rate Debt Securities even if the spread would exceed the amounts permitted by clause (A) above so long as the All-in Rate does not exceed a 6.0 percent "Hard Cap," plus an Unanticipated Fee Allowance as defined next.

   The Company may incur a new prevailing fee(s) (Unanticipated Fee Allowance), not to exceed an aggregate 100 basis points of affected principal. Avista must then demonstrate in its reporting to the Commission that this cost was new and market pervasive at time of issuance.

4. Hedging

The Company must comply with their internal hedging policies and will stand ready to provide its policy, its own analysis, and documentation to Staff for review upon request. The Company must not engage in the following in conjunction with Debt Securities issued hereunder:

A. Currency exchange hedging, with or without carry trade borrowing; or

B. Convertible debt (into either common or preferred stock).

5. Timely Reporting

A. Should the Company be engaged in general rate case proceedings with the Commission, the Company must provide written notice through the PUC filing center to the attention of PUC Staff named on the distribution list for this docket of any issuance within seven days calendar days of arrangement or term sheet availability. Further, should an issuance occur while general rate case settlement discussions are taking place, the Company is additionally obligated to inform such PUC Staff directly of such an issuance as soon as is reasonably possible and prior to the conclusion of settlement discussions regarding cost of capital.

B. The Company will provide the Commission with the customary Report of Securities Issued and Disposition of Net Proceeds statements no later than 60 calendar days after any transaction has been closed and funded, except that reporting on the Company's LTIP for the prior calendar year will be provided to the Commission on or before May 1st of each year. Reporting will be denominated in U.S. dollars and will include, but not be limited to: total value of the issuance; total and per unit fees and expenses; interest costs; credit ratings; copies of issuance documentation including itemized invoices for all external legal costs; an explanation of the Company's choices of placement, secured versus unsecured debt, and fixed- versus floating-rate debt; and how any hedging activities utilized best fit prevailing conditions, objectives, and expectations.

C. For each securities issuance under condition 3-B, the Company shall report to the Commission within 30 calendar days after any transaction is closed and funded regarding:

   i. The prevailing market conditions and if applicable, the causes for all-in spreads exceeding the relevant spreads specified in the appropriate Attachment (A or B) over the UST benchmark yields; and

   ii. The steps taken by the Company to control issuance costs.

6. <u>Maintenance of Credit Ratings</u>

If the Company's credit ratings fall below Investment Grade[3] as determined by either Standard & Poor's (S&P)[4] or Moody's,[5] authority granted by an Order issued pursuant to this application will be terminated.

7. <u>Reservation of Judgment Regarding Reasonableness</u>

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3 Investment grade long-term debt is rated BBB– or better by S&P, or Baa3 or better by Moody's.

4 S&P refers to Standard & Poor's, which is a subsidiary of The McGraw-Hill Companies.

5 Moody's refers to Moody's Investors Service, which is a division of Moody's Corporation.

> The Commission will reserve judgment on the reasonableness for ratemaking purposes of the Company's capital costs, capital structure, and the commissions, fees, and expenses incurred for security issuance. The Company will be required in future rate proceedings to show that capital costs and capital structure; maturities' concentration; issuance commissions, expenses and fees; and other factors are just and reasonable on both component and aggregate bases.

ISSUES:

Should the Commission authorize Avista to issue up to $435 million in debt securities, and to issue up to 3,155,348 common shares in its LTIP program, inclusive of all outstanding authority, taking account of potential reuse of stock awards not earned?

RULES:

Under Oregon Revised Statutes (ORS) ORS 757.410 a public utility must obtain Commission approval before issuing securities, stocks, bonds, notes or any evidence of indebtedness (collectively referred to as "issuances.") ORS 757.415 sets forth the purposes for which issuances can be made and authorizes the Commission to establish terms and conditions that are reasonable and in the public interest for any issuances authorized by the Commission. Oregon Administrative Rules (OAR) 860-027-0025[6] and 860-027-0030 set forth several specific requirements for applications submitted for Commission approval of an issuance.

DISCUSSION:

The Company filed an application September 11, 2015, for authority to issue and sell or exchange up to an aggregate incremental amount of $300 million in long-term debt securities having maturities of at least one year. In addition, Avista seeks authority to issue up to 1,635,000 incremental shares of common stock to replenish its LTIP.

On October 1, 2015, the Company amended its application to update the authorization requested. After updating its remaining shares under Avista's LTIP due to employment changes taking effect October 1, 2015 and all other changes, the Company requests authority to issue up to $435 million of Debt Securities and up to 2,021,360 shares of common stock through its LTIP, withdrawing prior like authorizations.

[6] Staff presumes OAR 860-027-0025 is applicable to issuance of First Mortgage Bonds.

First Mortgage Bonds (FMB):

The Company's application represents that Avista would most likely issue fixed-rate, secured long-term debt[7] in the form of FMBs, which have been the traditional debt financing vehicle utilized by utilities in the United States (U.S.). The Company's FMBs place a lien on its Mortgage and Deed of Trust, dated as of June 1, 1939. As amended and supplemented by various indentures since inception, the lien acts as collateral for bondholders, which should result in a higher credit rating than the Company's unsecured rating, and typically decreases the coupon rate at issuance as compared with otherwise similar unsecured debt.

Unsecured Debt Securities:

Avista further represents in its Company's application that, when market conditions and the Company's financial position warrant, authorization pursuant to this application will allow the Company to issue new unsecured debt with fixed- or floating-rates and having maturities generally between one and 40 years. The flexibility afforded by issuing debt securities with fixed- or floating-rates and having maturities over 30-years is consistent with previous Commission authorization pursuant to similar applications by other investor owned utilities[8] (IOU) under jurisdiction of the Commission.

Technical Expenses:

Underwriters' Commissions depicted in Attachment A represent the maximum commission to be paid by the Company. Avista represents its application that agent and underwriting commissions associated with the issuance of debt securities will not exceed usual and customary fees prevailing in the market and will not in any case exceed 0.875 percent of gross proceeds.

Attachment B shows the Company's expected expenses and net proceeds from the requested incremental $300 million of debt security issuance authority. These values are illustrative and may vary from actual market conditions at time of issuance. In future reporting and rate cases, the Company is required to show that its issuance costs were competitive and reflective of prevailing market conditions.

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7 Long-term debt as used in this Staff Report and the Company's application denotes debt having a maturity of over one year. Information regarding debt maturities less than one year is received by Staff for informational purposes only, consistent with ORS 757.415(3).

8 For example, in Docket No. UF 4263, Order No. 10-171 provided Idaho Power similar flexibility.

Spreads over U.S. Treasuries' (UST) Yields:

Staff utilized Bloomberg spreads over UST yields shown in Attachments C in lieu of information in the Company's filing. Staff considers spreads in Attachments A to be more reflective of current and near forward market conditions than spreads proposed by the Company in its application Exhibits L and M. Staff finds that the spreads over UST yields proposed by the Company generally provide more than sufficient "headroom" for upward movement in spreads, and exceed spreads for similar and recently issued utility debt securities.

Should all-in spreads exceed the relevant maximum spread over UST as set forth in Attachments A and B, the Company may still issue FMB or Debt Securities without further Commission approval if the all-in rate does not exceed a "hard cap" of 6.0 percent. Less than the Company's request of an 8.0 percent "hard cap," the Staff recommendation is based on Bloomberg's current data and market forward curves. Staff's recommendation is the highest value authorized by the Commission this year.

LTIP Detail:

The purpose of the Company's LTIP is to incent employee retention and to achieve corporate goals as adopted by shareholders on May 14, 1998. Stock authorizations are subject to LTIP provisions in the Company's application, including vesting requirements, and subsequent amendments. The LTIP was most recently amended by Avista's Board of Directors on February 6, 2015.

A key provision is that if shares are awarded or granted, but later not issued or partially issued based on vesting and corporate goals, such unissued shares are recaptured by the LTIP. Only when vesting, goals, and other requirements are met are shares issued.

For example, at 25 percent vesting per year, four years of continuous employment or service with the Company or its subsidiaries calculated from the grant date are necessary to reach 100 percent vesting.[9]

In general, the Company's infusion of incremental common shares into its LTIP program does not involve a sale of stock. However, Avista will stand ready to show that transaction and operating costs for the LTIP program are reasonable and prudent in subsequent rate cases.

Use of Proceeds:

The Company states that it may use proceeds from **Debt Securities** to:

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9 See page 11 of the current LTIP attached to the Company's application.

1. Do construction, facility improvement, and maintenance programs;
2. Retire or exchange outstanding stock, bond, note or other debt issuances;
3. Reimburse the Company treasury for funds previously expended; and
4. Meet other purposes, as may be permitted by law.

The Company has no single specific large project planned. Rather the entire $435M aggregate authorized Debt Securities would support usual utility purposes as described above, consistent with statutory requirements.[10]

The Company's **LTIP** seeks to enhance Avista's ability to retain its employees and other eligible participants. There is no change in purposes of prior authorizations listed in Condition 2 that this requested authority would replace.

Early Debt Security Redemption Features Authorized:

Avista may utilize early redemption features to provide financial flexibility. Whereupon, the Company will stand ready to demonstrate how any early redemption and refinancing executed was cost effective based on prevailing market conditions at execution.

A make-whole redemption feature allows an issuer to call Debt Securities at any time at a cost equal to the future debt service discounted back to the redemption date. Such provisions are usual and generally neutral or to ratepayers' benefit. The discount rate for a make-whole provision within a call feature is likely be a rate based on the prevailing treasury yield to remaining maturity plus additional basis points. This type of redemption does not typically require the issuer to pay a higher coupon or fee since the bond holder is effectively made whole.

Withdrawal of Prior Authority:

The Company requests new issuance authority without addressing cancellation of outstanding issuance authority. Avista supplemented its filing with updated numbers reflected herein. Outstanding authorization quantities are added to the quantity requested for each purpose respectively in the Company's application. This approach minimizes the number of active Commission authorizations for each given purpose. Limits shown in Condition 1 are informed by remaining outstanding authorizations set for termination in Condition 2. Consolidation of like authorizations minimizes reporting requirements. On issuance of a Commission Order in this docket, prior like authorizations are withdrawn and Conditions herein supersede conditions contained in prior orders.

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10 The Company's intended uses mirror those authorized in ORS 757.415(1).

Secured or unsecured Debt Securities may then be issued and sold or exchanged in any proportion and may be issued in any combination of differently sized public offerings or private placements provided that the combined total of these offerings does not exceed $435M, inclusive of any OID.

Due Diligence:

Staff reviewed all of the Avista's outstanding securities relying on resources at the St. Louis Federal Reserve (FRED), the US Security and Exchange Commission (SEC) — **E**lectronic **D**ata **G**athering, **A**nalysis and **R**etrieval (EDGAR), Bloomberg, SNL Financial (SNL), and Value Line (VL) assessments. The Company verified via email on September 14, 2015 that Avista's listing of securities in its application showing a 0.84 percent series due 12-20-2040 actually matures in 2016 consistent with Staff's data feeds. With that correction, the requested incremental $300 million of debt securities issuance authority is consistent with Company operations and necessary to support planned issuances for utility purposes.

No Harm:

Staff review of this application indicates that the Debt Securities and common stock for LTIP issuances requested will do no harm and can be expected to benefit ratepayers. Staff recommends approval of Avista's application as modified herein.

PROPOSED COMMISSION MOTION:

The Company's be granted authority to issue up to $435 million of Debt Securities and up to 2,021,360 shares of common stock through its LTIP, subject to Staff's conditions.

Attachments:

Attachment A: Maximum Allowable Commissions and Spreads
Attachment B: Estimated Net Proceeds for Debt Securities
Attachment C: Utility Debt Security Spreads over UST Yields

Attachment A

Maximum Allowable Agent and Underwriter Commissions,
& Spread over UST Yields at Time of Commitment
for Fixed-Rate Debt Securities in Normal Market Conditions

<table>
<tr><th colspan="2">Maturity</th><th rowspan="3">Maximum Underwriters Commission as Percentage of Aggregate Principal Amount of Debt Securities Sold</th><th colspan="2">Long-Term Debt Annual Spread</th></tr>
<tr><th>At Least</th><th>But Less Than</th><th>FMB</th><th>Unsecured Notes and other Debt Securities</th></tr>
<tr><th colspan="2">Years</th><th colspan="2">Basis Points (bps)</th></tr>
<tr><td>1</td><td>1.5</td><td rowspan="12">0.875%</td><td rowspan="5">175</td><td rowspan="5">200</td></tr>
<tr><td>1.5</td><td>2</td></tr>
<tr><td>2</td><td>3</td></tr>
<tr><td>3</td><td>4</td></tr>
<tr><td>4</td><td>5</td></tr>
<tr><td>5</td><td>7</td><td rowspan="2">200</td><td rowspan="2">225</td></tr>
<tr><td>7</td><td>10</td></tr>
<tr><td>10</td><td>12</td><td>225</td><td>250</td></tr>
<tr><td>12</td><td>15</td><td rowspan="2">230</td><td rowspan="2">260</td></tr>
<tr><td>15</td><td>20</td></tr>
<tr><td>20</td><td>30</td><td rowspan="2">255</td><td rowspan="2">285</td></tr>
<tr><td>30</td><td>40</td></tr>
</table>

Note: Comparing Bloomberg data[11] for like rated utility forwards, Staff finds that the schedule above provides access to capital under current market conditions with reasonable headroom for fixed rate combinations of issuances in public, and private placement with delayed start at no or minimal incremental cost that may benefit ratepayers over at least the next several years.

[11] Staff referenced Bloomberg FMB and Unsecured USD -indexed data on September 22, 2015.

Attachment B

Avista Corporation's

Anticipated Debt Securities Issuance Expenses

Item	$	Per $100		
Principal Amount (Face Value)	$300,000,000	$100.000		
Plus Premium or Less Discount	(Not Applicable)			
Underwriter Spread & Commissions	2,625,000	$ 0.875		
Proceeds Payable to Applicant	**$297,375,000**	$ 99.125		
Other Issuance / Technical Service Expenses	**Low**		**High**	
Rating Agency Fees	300,000	$ 0.100	500,000	$ 0.167
Primary Legal Fees	300,000	$ 0.100	500,000	$ 0.167
Regulatory Fees	50,000	$ 0.017	75,000	$ 0.025
Accountant's Fees	50,000	$ 0.017	75,000	$ 0.025
Printing & Engraving Expense	50,000	$ 0.017	75,000	$ 0.025
Miscellaneous Expenses	80,000	$ 0.027	120,000	$ 0.040
SubTotal	830,000	$ 0.277	1,345,000	$ 0.448
FMB IssuanceFees and Expenses	**Low**		**High**	
FMB Legal Fees	75,000	$ 0.025	150,000	$ 0.050
Title Insurance	80,000	$ 0.027	240,000	$ 0.080
County Filing and Other Fees	30,000	$ 0.010	100,000	$ 0.033
SubTotal	185,000	$ 0.338	490,000	$ 0.612
Total Estimated Commissions and Expenses	1,015,000	$ 0.338	1,835,000	$ 0.612
Net Estimated Amount to be Realized	**$296,360,000**	$ 98.787	**$295,540,000**	$98.513

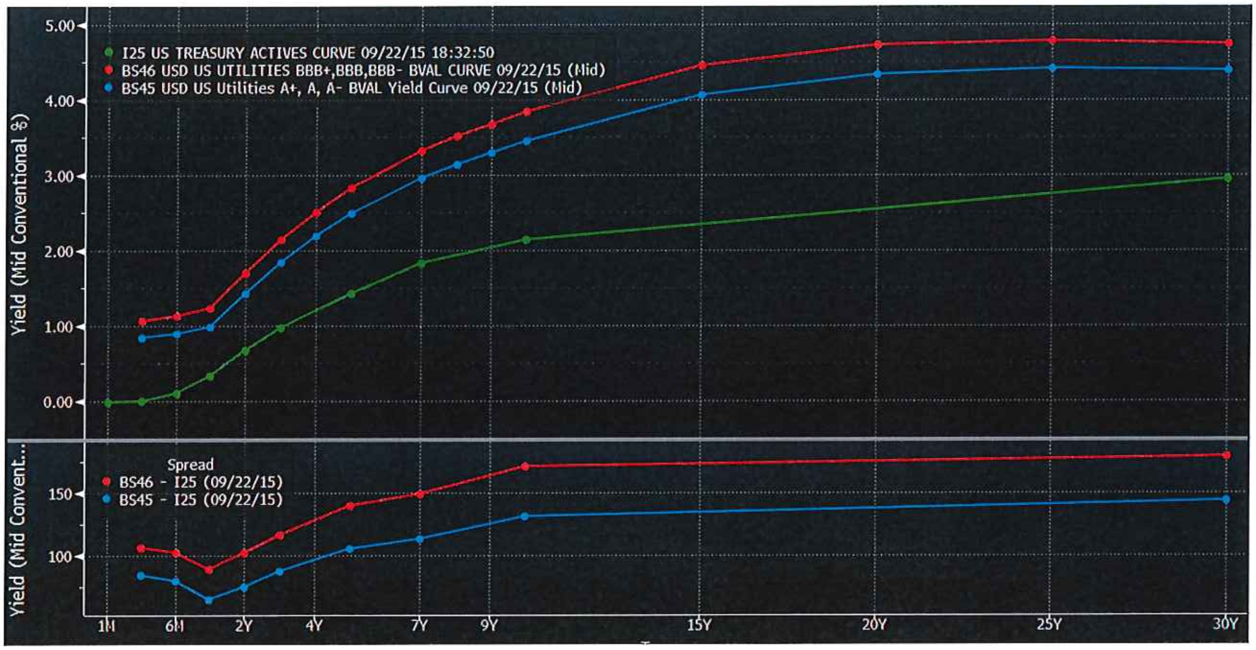
Attachment C

Bloomberg

Investment Grade Utility Spreads Over UST

Bloomberg CRVF Function Plot

Accessed by Staff on September 22, 2015



Referent Points of Interest:

10 Year Maturity Range from **A rated 132 bps** to B rated 171 bps,
30 Year Maturity Range from **A rated 145 bps** to B rated 179 bps.