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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UF 4202

In the Matter of)	
)	
AVISTA CORPORATION)	ORDER
)	
Application for Authority to Issue and Sell not more than \$62 Million of Securities.)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS AND REPORTING REQUIREMENTS

On February 19, 2004, Avista Corporation (Avista) filed an application with the Public Utility Commission of Oregon (Commission), pursuant to ORS 757.440, ORS 757.480, ORS 757.495, OAR 860-027-0030 and OAR 860-027-0040, requesting authority to issue and sell up to, and including, \$62 Million of Subordinated Debentures.¹ The basis for the current request is detailed in Staff's recommendation memo, attached as Appendix A and incorporated herein.

Based on a review of the application and the Commission's records, the Commission finds that this application satisfies applicable statutes and administrative rules. At its public meeting on March 16, 2004, the Commission adopted Staff's recommendation and approved Avista's current request.

ORDER

IT IS ORDERED THAT the application of Avista Corporation for authorization to issue and sell not more than \$62 Million of Securities is approved, subject to the following conditions and reporting requirements:

1. Avista shall file the usual Report of Securities Issued and Disposition of Net Proceeds statements as soon as possible after any issuance. This report shall include the total amount, per unit price, total expenses and net proceeds of the issuance.
2. Copies of (1) consummated Trust agreements and any other agreements arising from the establishment of the Trust; (2) final SEC S-3 form; (3) underwriter agreement; and, (4) prospectus from Lehman Brothers shall be included with Avista's Report of Securities Issued.
3. Avista shall provide an analysis that indicates the competitiveness of

¹ Unsecured, junior subordinated debt.

the rates it achieves and an analysis that indicates the degree to which any early refinancing, exchange or remarketing, including this issuance, is cost effective.

4. Avista shall, for rate making purposes, include all trust originated preferred securities as debt in the schedule that is provided to Staff.
5. Avista shall maintain all records that support the required affiliated interest transfer-pricing policy regarding both market prices and actual costs and shall pass through, in its regulated books, costs that are consistent with the Commission's transfer pricing policy. Annual costs for the Trust that are carried on Avista's books shall be reported in the annual Affiliate Interest report filed with the Commission. The report will include all interest charges, office overhead and management/governance fees along with other operating costs that are passed through to the Company.
6. The total expenses for this issuance shall not exceed 2.5% of the face value amount, including the costs of underwriting.
7. For ratemaking purposes, the Commission shall reserve judgment on the reasonableness of the Company's capital costs, capital structure and any associated commissions and expenses incurred for security issuances. In its next rate proceeding, Avista will be required to show that its capital costs, including imbedded expenses and structure, are just and reasonable.

Made, entered and effective _____.

BY THE COMMISSION:

Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: March 16, 2004**

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

DATE: March 22, 2004

TO: Lee Sparling through Marc Hellman and Bryan Conway

FROM: Ming Peng and Thomas Morgan

SUBJECT: AVISTA UTILITIES: (Docket No. UF 4202) Application for Authority to Issue and Sell not more than \$62 Million of Securities.

STAFF RECOMMENDATION:

The Commission should approve Avista Corporation's (Avista or Company) application to issue and guarantee not more than \$62 million of securities subject to the following conditions and reporting requirements:

1. Avista shall file the usual Report of Securities Issued and Disposition of Net Proceeds statements as soon as possible after any issuance. This report shall include the total amount, per unit price, total expenses and net proceeds of the issuance.
2. Copies of (1) consummated Trust agreements and any other agreements arising from the establishment of the Trust; (2) final SEC S-3 form; (3) underwriter agreement; and, (4) prospectus from Lehman Brothers shall be included with the Company's Report of Securities Issued.
3. The Company shall provide an analysis that indicates the competitiveness of the rates it achieves and an analysis that indicates the degree to which any early refinancing, exchange or remarketing, including this issuance, is cost effective.
4. Avista shall, for rate making purposes, include all trust originated preferred securities as debt in the schedule that is provided to Staff.
5. Avista shall maintain all records that support the required affiliated interest transfer-pricing policy regarding both market prices and actual costs and shall pass through, in its regulated books, costs that are consistent with the Commission's transfer pricing policy. Annual costs for the Trust that are carried on the books of Avista shall be reported in the annual Affiliate Interest

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report filed with the Commission. The report will include all interest charges, office overhead and management/governance fees along with other operating costs that are passed through to the Company.

6. The total expenses for this issuance shall not exceed 2.5% of the face value amount, including the costs of underwriting.
7. For ratemaking purposes, the Commission shall reserve judgment on the reasonableness of the Company's capital costs, capital structure and any associated commissions and expenses incurred for security issuances. In its next rate proceeding, the Company will be required to show that its capital costs, including imbedded expenses and structure, are just and reasonable.

DISCUSSION:

On February 18, 2004, Avista filed an application with the Commission, pursuant to Oregon Revised Statutes (ORS) 757.440, 757.480 & 757.495, and Oregon Administrative Rules (OAR) 860-27-0030 & 860-27-0040 for authority to issue and sell up to, and including, \$62,000,000 of Subordinated Debentures² (Debentures).

The Company proposes to offer, issue and sell the Debentures for a term up to 30 to 40 years and would be offered, issued and sold to a Delaware statutory trust (Trust)³. The Trust would offer, issue, and sell \$60 million in Trust Preferred Securities (Preferred Securities) to third-party, institutional investors and up to \$2 million in common securities to Avista. The common securities are about 3% equity, which reflects the minimum amount of equity that is required in these types of trusts from an accounting standpoint, in order to establish ownership of the trust.

The Company expects to be able to refinance the existing securities issue at a spread of about 400 basis points⁴ over the 5-year Treasury. The alternative of issuing unsecured debt would be less costly (likely 200 basis points lower); this option is not available to the Company due to existing loan covenants.

The Preferred Securities will have an initial fixed distribution rate not to exceed 7% of the face value for the first five years. Thereafter, the Company proposes that the Preferred Securities could be redeemed, or remarketed, with either a fixed or variable interest rate. The remarketing feature refers to the eventual resetting of the distribution rate/interest rate⁵ that will apply to the securities. The Company anticipates no further regulatory authority will be necessary at the time of redemption, remarketing, or conversion to a variable rate.

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² Unsecured, junior subordinated debt.

³ The Trust will be controlled by Avista and will be consolidated on the books of the Company.

⁴ Basis point is defined as one-hundredth of a percentage point; i.e., a 100 basis point equals 1 percent.

⁵ The rate on the debentures will always be exactly equal to the preferred distribution rate.

Expenses will be paid for out of the proceeds of the offering. The Debenture interest rate will equal the Preferred Securities distribution rate. The Preferred Securities will be outstanding the entire term of the Debentures.

Additionally, the Company would guarantee principal and distributions owed by the Trust, on a subordinated basis. In order for the Company to utilize this financing structure, a guarantee by the Company for the payments to the Trust is required. The Debentures allow that interest payments may be deferred for up to five years, providing additional flexibility to the Company.

The financing is structured in order to afford treatment of the Debentures as preferred securities by the rating agencies, with distribution payments that are deductible as interest expense for tax purposes. The Debentures would have the same cash flow payments stream as the Preferred Securities.

Rating agencies have historically classified Debentures as preferred securities for balance sheet purposes, while the distributions paid to the special purpose entity (i.e., the Trust) by the Company have been considered debt-service for tax purposes. The distributions on the Preferred Securities are guaranteed by the Company under a limited guaranty covering accrued and unpaid distributions from the Trust and the liquidation value of the securities. The terms and the fixed or variable distribution rate will be negotiated and determined by market conditions at the time of issuance.

Expenses

The Company expects that the underwriting expenses and other fees for the Debentures and the Preferred Securities will not exceed 2.5% (about \$1.5 million). The following summarizes the expected issuance costs:

Underwriters	\$900,000
Legal	\$300,000
Printing	\$25,000
Accounting	\$25,000
Rating agency fees	\$100,000
Trustee fees	\$25,000
<u>Other</u>	<u>\$25,000</u>
TOTAL	\$1,400,000

The underwriting fee and other expenses are consistent with fees associated with the Debentures/Preferred Securities arrangement and are in-line with that of similarly situated companies. It is higher than would be expected for straight debt and more similar to that of common equity.

Use of Proceeds

The Company will use the funds from this issuance to redeem \$60 million in aggregate outstanding principal amount of the Company's 7.875% Junior Deferrable Interest Debentures, Series A, Due 2037. This will, in turn, cause the redemption of the Avista Capital I 7.875% Trust Originated Preferred Securities, Series A. The redemption of outstanding debt is a use allowed by ORS 757.415, as it provides a lawful refunding of the Company's obligations.

Affiliated Interest Matters

Avista's application includes an affiliated interest transaction governed by ORS 757.495, because it will be borrowing money from a Trust that is controlled by the Company. Additionally, two officers of the Company will be Regular Trustees of the trust, although the specific individuals have not yet been named. Staff's review indicates that the application is consistent with the proper performance by the Company as a regulated public utility, will not impair the ability to perform that service, and is appropriate for the purpose allowed by law.

In a financing transaction involving affiliated interest, the Company is required to demonstrate that the transaction is fair and reasonable, and not contrary to the public interest. Staff believes Avista, with the adoption of proposed ordering conditions, will meet the Commission's transfer pricing policy for affiliated interest transactions. In addition, ORS 757.495 requires public utilities to seek approval of contracts with affiliated interests within 90 days after execution of the contract. The Commission approval of this application will satisfy those requirements.

Based on Staff's review, approval of Avista's application with the proposed conditions will provide reasonable access to the capital markets. The application appears fair and reasonable and not contrary to the public interest.

PROPOSED COMMISSION MOTION:

Avista's application for the authority to issue up to \$62 million in Debentures in connection with the Trust's issuance of Preferred Securities is approved with Staff's Conditions.

UF 4202 – Avista's Application to Issue Not More than \$62 Million in Securities