# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington D.C. 20549**

# FORM 10-Q

**(Mark One)**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2007**

**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)**

| **Washington** | **91-0462470** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **1411 East Mission Avenue, Spokane, Washington** | **99202-2600** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant's telephone number, including area code: 509-489-0500**
**Web site: http://www.avistacorp.com**

**None**
**(Former name, former address and former fiscal year, if changed since last report)**

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 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 ☒

As of April 30, 2007, 52,753,998 shares of Registrant's Common Stock, no par value (the only class of common stock), were outstanding.

AVISTA CORPORATION

Index



**FORWARD-LOOKING STATEMENTS**

Our Quarterly Report on Form 10-Q contains forward-looking statements, which should be read with the cautionary statements and important factors included at "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements" on pages 31-32. Forward-looking statements are all statements except those of historical fact, including, without limitation, those that are identified by the use of words that include "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. Many of these factors are beyond our control and could have a significant effect on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in our statements.

**CONSOLIDATED STATEMENTS OF INCOME**
**(Unaudited)**
*Avista Corporation*

For the Three Months Ended March 31
Dollars in thousands, except per share amounts

| | 2007 | 2006 |
|---|---|---|
| Operating Revenues: | | |
| Utility revenues | $414,266 | $423,290 |
| Non-utility energy marketing and trading revenues | 29,409 | 61,542 |
| Other non-utility revenues | 15,512 | 14,370 |
| Total operating revenues | 459,187 | 499,202 |
| Operating Expenses: | | |
| Utility operating expenses: | | |
| Resource costs | 269,986 | 271,605 |
| Other operating expenses | 49,041 | 45,727 |
| Depreciation and amortization | 21,090 | 20,980 |
| Taxes other than income taxes | 23,995 | 22,066 |
| Non-utility operating expenses: | | |
| Resource costs | 37,727 | 50,127 |
| Other operating expenses | 17,136 | 16,311 |
| Depreciation and amortization | 1,275 | 1,448 |
| Total operating expenses | 420,250 | 428,264 |
| Income from operations | 38,937 | 70,938 |
| Other Income (Expense): | | |
| Interest expense | (20,373) | (22,145) |
| Interest expense to affiliated trusts | (1,810) | (1,704) |
| Capitalized interest | 1,116 | 525 |
| Other income-net | 3,711 | 2,475 |
| Total other income (expense)-net | (17,356) | (20,849) |
| Income before income taxes | 21,581 | 50,089 |
| Income taxes | 7,487 | 18,517 |
| Net income | $ 14,094 | $ 31,572 |
| Weighted-average common shares outstanding (thousands), basic | 52,684 | 48,795 |
| Weighted-average common shares outstanding (thousands), diluted | 53,322 | 49,305 |
| Total earnings per common share, basic | $ 0.27 | $ 0.65 |
| Total earnings per common share, diluted | $ 0.26 | $ 0.64 |
| Dividends paid per common share | $ 0.145 | $ 0.140 |

***The Accompanying Notes are an Integral Part of These Statements.***

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**(Unaudited)**
*Avista Corporation*

For the Three Months Ended March 31
Dollars in thousands

| | 2007 | 2006 |
|---|---|---|
| Net income | $14,094 | $31,572 |
| Other Comprehensive Income (Loss): | | |
| Foreign currency translation adjustment | 114 | (18) |
| Unrealized gains on interest rate swap agreements - net of taxes of $28 and $2,047 | 52 | 3,801 |
| Change in unfunded benefit obligation for pension plan - net of taxes of $127 | 236 | — |
| Unrealized gains on derivative commodity instruments - net of taxes of $673 and $1,103 | 1,249 | 2,049 |
| Reclassification adjustment for realized gains on derivative commodity instruments included in net income - net of taxes of $(39) and $(335) | (73) | (623) |
| Unrealized investment gains - net of taxes of $2 | — | 4 |
| Total other comprehensive income | 1,578 | 5,213 |
| Comprehensive income | $15,672 | $36,785 |

***The Accompanying Notes are an Integral Part of These Statements.***

**CONSOLIDATED BALANCE SHEETS**
**(Unaudited)**
*Avista Corporation*

Dollars in thousands

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| **Assets:** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 56,974 | $ 28,242 |
| Restricted cash | 26,237 | 29,903 |
| Accounts and notes receivable-less allowances of $43,014 and $42,360 | 258,932 | 286,150 |
| Energy commodity derivative assets | — | 343,726 |
| Utility energy commodity derivative assets | 19,716 | 10,828 |
| Regulatory asset for utility derivatives | — | 62,650 |
| Funds held for customers | 91,506 | 90,134 |
| Deposits with counterparties | 85,366 | 79,477 |
| Materials and supplies, fuel stock and natural gas stored | 19,495 | 42,425 |
| Deferred income taxes | 14,769 | 10,932 |
| Assets held for sale | 600,962 | 3,543 |
| Other current assets | 29,068 | 44,264 |
| Total current assets | 1,203,025 | 1,032,274 |
| Net Utility Property: | | |
| Utility plant in service | 2,959,749 | 2,938,456 |
| Construction work in progress | 115,920 | 103,226 |
| Total | 3,075,669 | 3,041,682 |
| Less: Accumulated depreciation and amortization | 842,895 | 826,645 |
| Total net utility property | 2,232,774 | 2,215,037 |
| Other Property and Investments: | | |
| Investment in exchange power-net | 30,421 | 31,033 |
| Non-utility properties and investments-net | 59,955 | 60,301 |
| Non-current energy commodity derivative assets | — | 313,300 |
| Investment in affiliated trusts | 13,403 | 13,403 |
| Other property and investments-net | 16,829 | 15,594 |
| Total other property and investments | 120,608 | 433,631 |
| Deferred Charges: | | |
| Regulatory assets for deferred income tax | 104,718 | 105,935 |
| Regulatory assets for pensions and other postretirement benefits | 53,555 | 54,192 |
| Other regulatory assets | 31,578 | 31,752 |
| Non-current utility energy commodity derivative assets | 16,418 | 25,575 |
| Power and natural gas deferrals | 84,110 | 97,792 |
| Unamortized debt expense | 44,895 | 46,554 |
| Other deferred charges | 12,948 | 13,766 |
| Total deferred charges | 348,222 | 375,566 |
| Total assets | $ 3,904,629 | $ 4,056,508 |

***The Accompanying Notes are an Integral Part of These Statements.***

**CONSOLIDATED BALANCE SHEETS (continued)**
**(Unaudited)**
*Avista Corporation*

Dollars in thousands

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| **Liabilities and Stockholders' Equity:** | | |
| Current Liabilities: | | |
| Accounts payable | $ 243,910 | $ 286,099 |
| Energy commodity derivative liabilities | — | 313,499 |
| Customer fund obligations | 91,506 | 90,134 |
| Deposits from counterparties | 40,950 | 41,493 |
| Current portion of long-term debt | 14,607 | 26,605 |
| Current portion of preferred stock-cumulative | 26,250 | 26,250 |
| Short-term borrowings | — | 4,000 |
| Interest accrued | 25,468 | 11,595 |
| Utility energy commodity derivative liabilities | 14,658 | 73,478 |
| Liabilities held for sale | 574,372 | — |
| Other current liabilities | 76,365 | 72,056 |
| Total current liabilities | 1,108,086 | 945,209 |
| Long-term debt | 950,053 | 949,854 |
| Long-term debt to affiliated trusts | 113,403 | 113,403 |
| Other Non-Current Liabilities and Deferred Credits: | | |
| Non-current energy commodity derivative liabilities | — | 309,990 |
| Regulatory liability for utility plant retirement costs | 200,665 | 197,712 |
| Non-current regulatory liability for utility derivatives | 11,255 | 15,400 |
| Pensions and other postretirement benefits | 98,239 | 100,033 |
| Deferred income taxes | 430,393 | 461,006 |
| Other non-current liabilities and deferred credits | 65,261 | 47,055 |
| Total other non-current liabilities and deferred credits | 805,813 | 1,131,196 |
| Total liabilities | 2,977,355 | 3,139,662 |
| Commitments and Contingencies (See Notes to Consolidated Financial Statements) | | |
| Stockholders' Equity: | | |
| Common stock, no par value; 200,000,000 shares authorized; | | |
| 52,736,534 and 52,514,326 shares outstanding | 717,938 | 715,620 |
| Accumulated other comprehensive loss | (16,388) | (17,966) |
| Retained earnings | 225,724 | 219,192 |
| Total stockholders' equity | 927,274 | 916,846 |
| Total liabilities and stockholders' equity | $ 3,904,629 | $ 4,056,508 |

***The Accompanying Notes are an Integral Part of These Statements.***

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**
*Avista Corporation*

For the Three Months Ended March 31
Dollars in thousands

| | 2007 | 2006 |
|---|---|---|
| Operating Activities: | | |
| Net income | $ 14,094 | $ 31,572 |
| Non-cash items included in net income: | | |
| Depreciation and amortization | 22,365 | 22,428 |
| Benefit for deferred income taxes | (11,411) | (3,301) |
| Power and natural gas cost amortizations, net of deferrals | 14,884 | 19,409 |
| Amortization of debt expense | 1,704 | 1,917 |
| Unrealized loss (gain) on energy commodity derivatives | 20,933 | (6,140) |
| Other | 1,076 | (4,768) |
| Changes in working capital components: | | |
| Accounts and notes receivable | 26,564 | 155,116 |
| Materials and supplies, fuel stock and natural gas stored | 15,062 | 9,447 |
| Deposits with counterparties | (5,889) | 15,223 |
| Other current assets | 13,824 | (4,322) |
| Accounts payable | (36,877) | (167,980) |
| Deposits from counterparties | (543) | (3,999) |
| Other current liabilities | 14,496 | 42,486 |
| Net cash provided by operating activities | 90,282 | 107,088 |
| Investing Activities: | | |
| Utility property capital expenditures (excluding equity-related AFUDC) | (40,556) | (29,743) |
| Proceeds from sale of utility property claim | — | 5,484 |
| Other capital expenditures | (1,339) | (637) |
| Decrease in restricted cash | 3,666 | 1,873 |
| Changes in other property and investments | (1,196) | (194) |
| Proceeds from property sales | 215 | 6,840 |
| Net cash used in investing activities | (39,210) | (16,377) |
| Financing Activities: | | |
| Decrease in short-term borrowings | (4,000) | (40,004) |
| Redemption and maturity of long-term debt | (12,255) | (421) |
| Cash dividends paid | (7,645) | (6,803) |
| Issuance of common stock | 1,630 | 1,792 |
| Long-term debt and short-term borrowing issuance costs | (70) | (102) |
| Net cash used in financing activities | (22,340) | (45,538) |
| Net increase in cash and cash equivalents | 28,732 | 45,173 |
| Cash and cash equivalents at beginning of period | 28,242 | 25,917 |
| Cash and cash equivalents at end of period | $ 56,974 | $ 71,090 |
| Supplemental Cash Flow Information: | | |
| Cash paid during the period: | | |
| Interest | $ 6,606 | $ 13,536 |
| Income taxes | — | 194 |

***The Accompanying Notes are an Integral Part of These Statements.***

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended March 31, 2007 and 2006 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results for the interim periods. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The Consolidated Statements of Income for the interim periods are not necessarily indicative of the results to be expected for the full year. These consolidated financial statements do not contain the detail or footnote disclosure concerning accounting policies and other matters which would be included in full fiscal year consolidated financial statements; therefore, they should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K). Please refer to the section "Acronyms and Terms" in the 2006 Form 10-K for definitions of terms such as capacity, energy and therm.

### NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Nature of Business***

Avista Corp. is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. Avista Utilities is an operating division of Avista Corp., comprising the regulated utility operations. Avista Utilities generates, transmits and distributes electricity in parts of eastern Washington and northern Idaho. In addition, Avista Utilities has electric generating facilities in western Montana and northern Oregon. Avista Utilities also provides natural gas distribution service in parts of eastern Washington and northern Idaho, as well as parts of northeast and southwest Oregon. Avista Capital, Inc. (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, including Avista Energy, Inc. (Avista Energy) and Advantage IQ, Inc. (Advantage IQ). Avista Energy is an electricity and natural gas marketing, trading and resource management business. Advantage IQ is a provider of facility information and cost management services for multi-site customers throughout North America. See Note 14 for business segment information.

The Company's operations are exposed to risks including, but not limited to:

- price and supply of purchased power, fuel and natural gas,
- regulatory recovery of power and natural gas costs and capital investments,
- streamflow and weather conditions,
- effects of changes in legislative and governmental regulations,
- changes in regulatory requirements,
- availability of generation facilities,
- competition,
- technology, and
- availability of funding.

Also, like other utilities, the Company's facilities and operations are exposed to terrorism risks or other malicious acts. In addition, the energy business exposes the Company to the financial, liquidity, credit and price risks associated with wholesale purchases and sales of energy commodities.

***Basis of Reporting***

The consolidated financial statements include the assets, liabilities, revenues and expenses of the Company and its subsidiaries, including variable interest entities for which the Company or its subsidiaries are the primary beneficiaries. All significant intercompany balances have been eliminated in consolidation. The accompanying financial statements include the Company's proportionate share of utility plant and related operations resulting from its interests in jointly owned plants.

***Use of Estimates***

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Significant estimates include:

- determining the market value of energy commodity derivative assets and liabilities,
- pension and other postretirement benefit plan obligations,

- contingent liabilities,
- recoverability of regulatory assets,
- stock-based compensation, and
- unbilled revenues.

Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on the consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein.

***Utility Revenues***

Utility revenues related to the sale of energy are generally recorded when service is rendered or energy is delivered to customers. The determination of the energy sales to individual customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each calendar month, the amount of energy delivered to customers since the date of the last meter reading is estimated and the corresponding unbilled revenue is estimated and recorded. Revenues and resource costs from Avista Utilities' settled energy contracts that are "booked out" (not physically delivered) are reported on a net basis as part of utility revenues.

***Non-Utility Energy Marketing and Trading Revenues***

Avista Energy follows Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, for the majority of its contracts. Avista Energy reports the net margin on derivative commodity instruments held for trading as non-utility energy marketing and trading revenues. Revenues from contracts that are not derivatives under SFAS No. 133, as well as derivative commodity instruments not held for trading, are reported on a gross basis in non-utility energy marketing and trading revenues. Revenues from Canadian contracts through Avista Energy Canada, Ltd. (Avista Energy Canada), which are not held for trading and are reported on a gross basis in non-utility energy marketing and trading revenues, were $38.6 million for the three months ended March 31, 2007 and $42.8 million for the three months ended March 31, 2006. On April 16, 2007, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement to sell substantially all of their contracts and ongoing operations. See Note 3 for further information.

***Other Non-Utility Revenues***

Service revenues from Advantage IQ are recognized in the period services are rendered. Setup fees are deferred and recognized over the term of the related customer contracts. Interest earnings on funds held for customers are an integral part of Advantage IQ's product offerings and are recognized in revenues as earned. Revenues in the other business segment are primarily derived from the operations of Advanced Manufacturing and Development and are recognized when the risk of loss transfers to the customer, which generally occurs when products are shipped.

***Other Income-Net***

Other income-net consisted of the following items for the three months ended March 31 (dollars in thousands):

| | 2007 | 2006 |
|---|---|---|
| Interest income | $ 2,474 | $ 1,903 |
| Interest on power and natural gas deferrals | 1,203 | 1,907 |
| Net gain (loss) on investments | 444 | (433) |
| Other expense | (1,424) | (1,488) |
| Other income | 1,014 | 586 |
| Total | $ 3,711 | $ 2,475 |

***Accumulated Other Comprehensive Income (Loss)***

Accumulated other comprehensive income (loss), net of tax, consisted of the following as of March 31, 2007 and December 31, 2006 (dollars in thousands):

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Foreign currency translation adjustment | $ 1,483 | $ 1,369 |
| Unfunded benefit obligation for the pension plan | (15,746) | (15,982) |
| Unrealized loss on interest rate swap agreements | (3,294) | (3,346) |
| Unrealized gain (loss) on derivative commodity instruments | 1,169 | (7) |
| Total accumulated other comprehensive loss | $(16,388) | $ (17,966) |

***Assets Held for Sale***

Assets held for sale are recorded at the lower of their carrying amount or fair value less cost to sell. As of March 31, 2007, assets held for sale included $597.5 million of assets from Avista Energy (including energy commodity derivative assets, natural gas inventory, goodwill and certain fixed assets; see Note 3 for further information), as well as $3.5 million of turbines and related equipment at Avista Utilities. As of December 31, 2006, assets held for sale included $3.5 million of turbines and related equipment at Avista Utilities. Liabilities held for sale of $574.4 million as of March 31, 2007 represent energy commodity derivative liabilities at Avista Energy. There were not any liabilities held for sale as of December 31, 2006.

***Regulatory Deferred Charges and Credits***

The Company prepares its consolidated financial statements in accordance with the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." The Company prepares its financial statements in accordance with SFAS No. 71 because:

- rates for regulated services are established by or subject to approval by an independent third-party regulator,
- the regulated rates are designed to recover the cost of providing the regulated services, and
- in view of demand for the regulated services and the level of competition, it is reasonable to assume that rates can be charged to and collected from customers at levels that will recover costs.

SFAS No. 71 requires the Company to reflect the impact of regulatory decisions in its financial statements. SFAS No. 71 requires that certain costs and/or obligations (such as incurred power and natural gas costs not currently recovered through rates, but expected to be recovered in the future) are reflected as deferred charges or credits on the Consolidated Balance Sheets. These costs and/or obligations are not reflected in the statement of income until the period during which matching revenues are recognized.

If at some point in the future the Company determines that it no longer meets the criteria for continued application of SFAS No. 71 for all or a portion of its regulated operations, the Company could be:

- required to write off its regulatory assets, and
- precluded from the future deferral of costs not recovered through rates at the time such costs are incurred, even if the Company expected to recover such costs in the future.

The Company's primary regulatory assets include:

- power and natural gas deferrals,
- investment in exchange power,
- regulatory asset for deferred income taxes,
- unamortized debt expense,
- demand side management programs,
- conservation programs, and
- unfunded pensions and other postretirement benefits.

Those items without a specific line on the Consolidated Balance Sheets are included in other regulatory assets.

Regulatory liabilities include:

- utility plant retirement costs,
- liabilities created when the Centralia Power Plant was sold,
- liabilities offsetting net utility energy commodity derivative assets (see Note 5 for further information), and
- the gain on the general office building sale/leaseback.

Those items without a specific line on the Consolidated Balance Sheets are included in other current liabilities and other non-current liabilities and deferred credits.

***Reclassifications***

Certain prior period amounts were reclassified to conform to current statement format. These reclassifications were made for comparative purposes and have not affected previously reported total net income or stockholders' equity.

**NOTE 2. NEW ACCOUNTING STANDARDS**

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109," (FIN 48) which provides guidance for the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires the evaluation of a tax position as a two-step process. First, the Company is required to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the "more likely than not" recognition threshold, it is then measured and recorded at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company adopted FIN 48 in the first quarter of 2007 (effective January 1, 2007). The adoption of FIN 48 did not have a cumulative effect on the Company's financial condition and results of operations. See Note 8 for further information.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. This statement also expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements. However, the statement does not require any new fair value measurements. This statement emphasizes that fair value is a market-based measurement and not an entity-specific measurement. Therefore a fair value measurement should be determined based on the assumptions that market participants would use in pricing an asset or liability. The statement establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. The Company will be required to adopt SFAS No. 157 in 2008. The Company is evaluating the impact SFAS No. 157 will have on its financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected would be reported in net income. The Company will be required to adopt SFAS No. 159 in 2008. The Company is evaluating the impact SFAS No. 159 will have on its financial condition and results of operations.

**NOTE 3. DISPOSITION OF AVISTA ENERGY**

On April 16, 2007, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement with Coral Energy Holding, L.P. (Coral Energy), a subsidiary of the Shell Group of Companies, as well as certain other subsidiaries of Coral Energy. Pursuant to the agreement, Avista Energy will sell substantially all of its contracts and ongoing operations to Coral Energy and Avista Energy Canada will sell substantially all of its contracts and ongoing operations to Coral Energy Canada Inc., a subsidiary of Coral Energy.

Avista Corp. explored whether it should continue in this business over the long term or if any strategic alternatives were available. Energy commodity derivative assets, natural gas inventory and certain other assets of Avista Energy are accounted for as held for sale as of March 31, 2007 because the decision to sell these assets was made prior to that date. Until the transaction is completed, Avista Energy's results of operations will continue to be reflected in Avista Corp.'s consolidated financial statements.

The transaction will be completed through the purchase and sale agreement and certain other ancillary agreements. As consideration for the assets acquired (net of liabilities assumed), the purchase price to be paid by Coral Energy will be calculated on the closing date as the sum of the following (subject to certain adjustments):

- the net trade book value of contracts acquired,
- the market value of the natural gas inventory, and
- the net book value of the tangible fixed assets acquired.

After closing costs and other adjustments, the transaction is not expected to result in a significant gain or loss for Avista Corp. This expectation could change due to several factors including, but not limited to, changes in the market value of natural gas inventory and certain other contracts and changes in the estimate of transaction costs and other costs associated with closing out Avista Energy's operations. Proceeds from the transaction will include cash consideration for the net assets acquired by Coral Energy as described above and liquidation of the net current assets of Avista Energy not sold to Coral Energy (primarily receivables, restricted cash and deposits with counterparties). Over time, Avista Corp. plans to redeploy the majority of the proceeds from the transaction into its regulated utility operations by reducing debt and investing in capital assets. For reference, the net book value of Avista Energy as shown on its balance sheet as of March 31, 2007 was $202 million.

Avista Energy's assets held for sale consisted of the following as of March 31, 2007 (dollars in thousands):

| | |
|---|---|
| Energy commodity derivative assets | $588,784 |
| Natural gas inventory | 7,868 |
| Goodwill | 1,009 |
| Fixed assets | 336 |
| Adjustment to estimated fair value less selling costs | (494) |
| Total assets held for sale of Avista Energy | $597,503 |

Liabilities held for sale of $574.4 million consisted of energy commodity derivative liabilities.

Assets and liabilities which will be excluded from the sale and retained by Avista Energy include:

- cash,
- certain agreements related to a power generation facility located in Idaho after December 31, 2009,
- storage rights at a natural gas facility located in Washington after April 30, 2011,
- accounts receivable,
- certain software, hardware, licenses and permits,
- accounts payable,
- obligations related to Avista Energy's credit agreement,
- tax obligations,
- cash deposits with and from counterparties,
- litigation matters (including matters related to western energy markets), and
- certain employment agreements and employee related obligations.

At the closing of the transaction, Avista Energy and its affiliates will enter into an Indemnification Agreement with Coral Energy and its affiliates under which Avista Energy and Coral Energy each agree to provide indemnification of the other and the other's affiliates for certain events arising out of and matters described in the purchase and sale agreement and certain other transaction agreements. Such events and matters include, but are not limited to, the refund proceedings arising out of the dysfunctions of western energy markets in 2000 and 2001 (see Note 12), existing litigation, environmental matters, employee-related matters, tax liabilities, matters with respect to storage rights at a natural gas storage facility located in Washington, and any potential claims associated with energy conversion, electric transmission and natural gas transportation agreements relating to a power generation facility located in Idaho. Such indemnification is generally limited to an aggregate amount of $30 million and a term of three years (except for agreements with terms longer than three years). This limitation does not apply to certain third party claims.

Avista Energy's obligations under the indemnification agreement will be guaranteed by Avista Capital up to an aggregate amount of $30 million. Avista Capital will be granting Coral Energy a security interest in 50 percent of Avista Capital's common shares of Advantage IQ as collateral for its guarantee. The aggregate obligations secured by this security interest will in no event exceed $25 million. This security interest will terminate 18 months after closing except to the extent of claims actually made prior to expiration of the 18-month period.

Avista Energy has made customary representations, warranties and covenants in the purchase and sale agreement. Avista Corp. and its subsidiaries have agreed that for a period of 60 calendar months beginning on the closing of the transaction, neither Avista Corp. nor any of its subsidiaries will form or participate through ownership or any alliance, or internally, develop capabilities to replicate the business activities of Avista Energy within the region of the Western Electric Coordinating Council. This restriction has certain exceptions primarily related to any assets or contracts retained by Avista Energy and any current corporate activities outside of Avista Energy, including any resource optimization or associated trading or hedging activities of the character currently being conducted by Avista Utilities, an operating division of Avista Corp., in the ordinary course of its regulated utility business (see Notes 5 and 6).

The closing of the sale is subject to customary conditions including, but not limited to, release of all liens on the assets being acquired, the receipt of certain regulatory approvals (including applicable Federal Energy Regulatory Commission approvals) and the consents of parties to certain contracts to the assignment of those contracts. The closing date is expected to be late in the second quarter or early in the third quarter of 2007.

**NOTE 4. ACCOUNTS RECEIVABLE SALE**

Avista Receivables Corporation (ARC) is a wholly owned, bankruptcy-remote subsidiary of Avista Corp., formed for the purpose of acquiring or purchasing interests in certain accounts receivable, both billed and unbilled, of the Company. On March 19, 2007, Avista Corp., ARC and a third-party financial institution amended a Receivables Purchase Agreement. The most significant amendment was to extend the termination date from March 20, 2007 to March 17, 2008. Under the Receivables Purchase Agreement, ARC can sell without recourse, on a revolving basis, up to $85.0 million of those receivables. ARC is obligated to pay fees that approximate the purchaser's cost of issuing commercial paper equal in value to the interests in receivables sold. On a consolidated basis, the amount of such fees is included in other operating expenses of Avista Corp. The Receivables Purchase Agreement has financial covenants, which are substantially the same as those of Avista Corp.'s $320.0 million committed line of credit (see Note 9). As of March 31, 2007, $68.0 million in accounts receivables were sold under this revolving agreement, a decrease from $85.0 million as of December 31, 2006.

**NOTE 5. UTILITY ENERGY COMMODITY DERIVATIVE ASSETS AND LIABILITIES**

SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires the recording of all derivatives as either assets or liabilities on the balance sheet measured at estimated fair value and the recognition of the unrealized gains and losses. In certain defined conditions, a derivative may be specifically designated as a hedge for a particular exposure. The accounting for derivatives depends on the intended use of the derivatives and the resulting designation.

Avista Utilities enters into forward contracts to purchase or sell electricity and natural gas. Under these forward contracts, Avista Utilities commits to purchase or sell a specified amount of energy at a specified time, or during a specified period, in the future. Certain of these forward contracts are considered derivative instruments. Avista Utilities also records derivative commodity assets and liabilities for over-the-counter and exchange-traded derivative instruments as well as certain long-term contracts. These contracts are entered into as part of Avista Utilities' management of its loads and resources as discussed in Note 6. In conjunction with the issuance of SFAS No. 133, the Washington Utilities and Transportation Commission (WUTC) and the Idaho Public Utilities Commission (IPUC) issued accounting orders authorizing Avista Utilities to offset any derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of settlement. The orders provide for Avista Utilities to not recognize the unrealized gain or loss on utility derivative commodity instruments in the Consolidated Statements of Income. Realized gains and losses are recognized in the period of settlement, subject to approval for recovery through retail rates. Realized gains and losses, subject to regulatory approval, result in adjustments to retail rates through purchased gas cost adjustments, the Energy Recovery Mechanism in Washington and the Power Cost Adjustment mechanism in Idaho.

Substantially all forward contracts to purchase or sell power and natural gas are recorded as assets or liabilities at estimated fair value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives under SFAS No. 133 are generally accounted for at cost until they are settled or realized, unless there is a decline in the fair value of the contract that is determined to be other than temporary.

Utility energy commodity derivatives consisted of the following as of March 31, 2007 and December 31, 2006 (dollars in thousands):

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Current utility energy commodity derivative assets | $ 19,716 | $ 10,828 |
| Current utility energy commodity derivative liabilities | (14,658) | (73,478) |
| Net current regulatory liability (asset) | $ 5,058 | $ (62,650) |
| Non-current utility energy commodity derivative assets | $ 16,418 | $ 25,575 |
| Non-current utility energy commodity derivative liabilities | (5,163) | (10,175) |
| Net non-current regulatory liability | $ 11,255 | $ 15,400 |

The net current regulatory liability as of March 31, 2007 is included in other current liabilities on the Consolidated Balance Sheet. Non-current utility energy commodity derivative liabilities are included in other non-current liabilities and deferred credits on the Consolidated Balance Sheets.

**NOTE 6. ENERGY COMMODITY TRADING**

The Company's energy-related businesses are exposed to risks relating to, but not limited to:

- changes in certain commodity prices,
- interest rates,
- foreign currency, and
- counterparty performance.

Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options in order to manage the various risks relating to these exposures, and Avista Energy engages in the trading of such instruments. Avista Utilities and Avista Energy use a variety of techniques to manage risks for their energy resources and wholesale energy market activities. The Company has risk management policies and procedures to manage these risks, both qualitative and quantitative, for Avista Utilities and Avista Energy. The Company's Risk Management Committee establishes the Company's risk management policies and procedures and monitors compliance. The Risk Management Committee is comprised of certain Company officers and other individuals and is overseen by the Audit Committee of the Company's Board of Directors.

***Avista Utilities***

Avista Utilities engages in an ongoing process of resource optimization, which involves the economic selection from available resources to serve Avista Utilities' load obligations and uses its existing resources to capture available economic value. Avista Utilities sells and purchases wholesale electric capacity and energy and fuel as part of the process of acquiring resources to serve its load obligations. These transactions range from terms of one hour up to multiple years. Avista Utilities makes continuing projections of:

- loads at various points in time (ranging from one hour to multiple years) based on, among other things, estimates of factors such as customer usage and weather, as well as historical data and contract terms, and
- resource availability at these points in time based on, among other things, estimates of streamflows, availability of generating units, historic and forward market information and experience.

On the basis of these projections, Avista Utilities makes purchases and sales of energy to match expected resources to expected electric load requirements. Resource optimization involves generating plant dispatch and scheduling available resources and also includes transactions such as:

- purchasing fuel for generation,
- when economic, selling fuel and substituting wholesale purchases for the operation of Avista Utilities' resources, and
- other wholesale transactions to capture the value of generation and transmission resources.

Avista Utilities' optimization process includes entering into hedging transactions to manage risks.

As part of its resource optimization process described above, Avista Utilities manages the impact of fluctuations in electric energy prices by measuring and controlling the volume of energy imbalance between projected loads and resources and through the use of derivative commodity instruments for hedging purposes. Load/resource imbalances within a rolling 18-month planning horizon are compared against established volumetric guidelines and management determines the timing and specific actions to manage the imbalances. Management also assesses available resource decisions and actions that are appropriate for longer-term planning periods.

***Avista Energy***

As disclosed in Note 3, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement to sell substantially all of their contracts and ongoing operations. Until the transaction is completed, Avista Energy's results of operations will continue to be reflected in Avista Corp's consolidated financial statements.

Avista Energy has implemented hedge accounting in accordance with SFAS No. 133. Specific natural gas and electric trading derivative contracts have been designated as hedging instruments in cash flow hedging relationships. The hedge strategies represent cash flow hedges of the variable price risk associated with expected purchases of natural gas and sales of electricity. These designated hedging instruments represent hedges of variable price exposures generated from certain contracts, which do not qualify as derivatives under SFAS No. 133. For all derivatives designated as cash flow hedges, Avista Energy documents the:

- relationship between the hedging instrument and the hedged item (forecasted purchases and sales of power and natural gas), and
- risk management objective and strategy for using the hedging instrument.

Avista Energy assesses whether a change in the value of the designated derivative is highly effective in achieving offsetting cash flows attributable to the hedged item, both at the inception of the hedge and on an ongoing basis. Any changes in the fair value of the designated derivative that are effective are recorded in accumulated other comprehensive income or loss, while changes in fair value that are not effective are recognized currently in earnings as operating revenues. Amounts recorded in accumulated other comprehensive income or loss are recognized in earnings during the period that the hedged items are recognized in earnings. The following table presents activity related to Avista Energy's hedge accounting during the three months ended March 31 (dollars in thousands):

| | 2007 | 2006 |
|---|---|---|
| Gain related to hedge ineffectiveness recorded in operating revenues | $510 | $— |
| Gain reclassified from accumulated other comprehensive income (loss) and recognized in earnings (pre-tax) | 112 | 958 |

The following table presents the net gain (loss), net of tax, related to Avista Energy's cash flow hedges as of March 31, 2007 and December 31, 2006 (dollars in thousands):

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Accumulated other comprehensive income related to natural gas derivatives | $ 2,929 | $ 272 |
| Accumulated other comprehensive loss related to electric derivatives | (1,760) | (279) |
| Total accumulated other comprehensive income (loss) | $ 1,169 | $ (7) |

Avista Energy expects to recognize a gain of $0.8 million in earnings during the next 12 months, related to amounts currently in accumulated other comprehensive income. The actual amounts that will be recognized in Avista Energy's earnings during the next 12 months will vary from the expected amounts as a result of changes in market prices. The maximum term of the designated hedging instruments is 12 months.

**Contract Amounts and Terms** Under Avista Energy's derivative instruments, Avista Energy either (i) as "fixed price payor," is obligated to pay a fixed price or a fixed amount and is entitled to receive the commodity or a fixed amount, (ii) as "fixed price receiver," is entitled to receive a fixed price or a fixed amount and is obligated to deliver the commodity or pay a fixed amount, (iii) as "index price payor," is obligated to pay an indexed price or an indexed amount and is entitled to receive the commodity or a variable amount or (iv) as "index price receiver," is entitled to receive an indexed price or amount and is obligated to deliver the commodity or pay a variable amount. The contract or notional amounts and terms of Avista Energy's derivative commodity instruments outstanding as of March 31, 2007 are set forth below (in thousands of MWhs and mmBTUs):

| | Fixed Price Payor | Fixed Price Receiver | Maximum Terms in Years | Index Price Payor | Index Price Receiver | Maximum Terms in Years |
|---|---|---|---|---|---|---|
| Energy commodities (volumes) | | | | | | |
| Electric | 26,083 | 27,988 | 10 | 7,357 | 6,584 | 3 |
| Natural gas | 104,542 | 90,409 | 5 | 531,191 | 549,378 | 5 |

The weighted average term of Avista Energy's electric derivative commodity instruments as of March 31, 2007 was approximately 6 months. The weighted average term of Avista Energy's natural gas derivative commodity instruments as of March 31, 2007 was approximately 5 months.

**Estimated Fair Value** The estimated fair value of Avista Energy's derivative commodity instruments outstanding as of March 31, 2007 (all of which are classified as assets and liabilities held for sale), and the average estimated fair value of those instruments held during the year ended March 31, 2007, are set forth below (dollars in thousands):

| | Estimated Fair Value as of March 31, 2007 | | | | Average Estimated Fair Value for the three months ended March 31, 2007 | | | |
|---|---|---|---|---|---|---|---|---|
| | Current Assets | Long-term Assets | Current Liabilities | Long-term Liabilities | Current Assets | Long-term Assets | Current Liabilities | Long-term Liabilities |
| Electric | $ 212,878 | $ 300,721 | $ 200,922 | $ 295,468 | $ 180,516 | $ 290,271 | $ 162,253 | $ 283,309 |
| Natural gas | 60,804 | 14,381 | 64,640 | 13,341 | 108,728 | 17,207 | 110,269 | 20,166 |
| Total | $ 273,682 | $ 315,102 | $ 265,562 | $ 308,809 | $ 289,244 | $ 307,478 | $ 272,522 | $ 303,475 |

The change in the estimated fair value position of Avista Energy's energy commodity portfolio, net of reserves for credit and market risk for the three months ended March 31, 2007 was an unrealized loss of $20.9 million and is included in the Consolidated Statements of Income in non-utility energy marketing and trading revenues. The change in the fair value position for the three months ended March 31, 2006 was an unrealized gain of $6.1 million.

**NOTE 7. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS**

The Company has a defined benefit pension plan covering substantially all regular full-time employees at Avista Utilities and Avista Energy. Individual benefits under this plan are based upon the employee's years of service and average compensation as specified in the plan. The Company's funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax purposes. The Company made $15 million in cash contributions to the pension plan in 2006 and expects to contribute $15 million to the pension plan in 2007.

The Company also has a Supplemental Executive Retirement Plan (SERP) that provides additional pension benefits to executive officers of the Company. The SERP is intended to provide benefits to executive officers whose benefits under the pension plan are reduced due to the application of Section 415 of the Internal Revenue Code of 1986 and the deferral of salary under deferred compensation plans.

The Company provides certain health care and life insurance benefits for substantially all of its retired employees. The Company accrues the estimated cost of postretirement benefit obligations during the years that employees provide services.

The Company established a Health Reimbursement Arrangement to provide employees with tax-advantaged funds to pay for allowable medical expenses upon retirement. The amount earned by the employee is fixed on the retirement date based on employees' years of service and the ending salary. The liability and expense of this plan are included as other postretirement benefits.

The Company uses a December 31 measurement date for its pension and postretirement plans. The following table sets forth the components of net periodic benefit costs for the three months ended March 31 (dollars in thousands):

| | Pension Benefits | | Other Post-retirement Benefits | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | $ 2,740 | $ 2,495 | $ 136 | $ 175 |
| Interest cost | 4,766 | 4,231 | 439 | 416 |
| Expected return on plan assets | (4,802) | (4,236) | (391) | (342) |
| Transition obligation recognition | — | — | 126 | 126 |
| Amortization of prior service cost | 164 | 164 | — | — |
| Net loss recognition | 769 | 847 | 57 | 86 |
| Net periodic benefit cost | $ 3,637 | $ 3,501 | $ 367 | $ 461 |

**NOTE 8. ACCOUNTING FOR INCOME TAXES**

As disclosed in Note 2, the Company adopted FIN 48 during the first quarter of 2007 (effective January 1, 2007), which did not have a cumulative effect on the Company's financial condition and results of operations.

The Company and its eligible subsidiaries file consolidated federal income tax returns. The Company also files state income tax returns in certain jurisdictions, including Idaho, Oregon, Montana and California. Subsidiaries are charged or credited with the tax effects of their operations on a stand-alone basis. The Internal Revenue Service (IRS) has examined the Company's 2001, 2002 and 2003 federal income tax returns. Despite those tax years still remaining open, all issues have been resolved with the exception of certain indirect overhead costs. The IRS is currently conducting an examination of the Company's 2004 and 2005 federal income tax returns. This examination could result in a change in the liability for uncertain tax positions. However, an estimate of the range of any such possible change cannot be made at this time. The Company does not believe that any open tax years with respect to state income taxes could result in any adjustments that would be significant to the consolidated financial statements.

In August 2005, the Treasury Department issued regulations and the IRS issued a revenue ruling that affect the tax treatment by Avista Corp. of certain indirect overhead expenses. Avista Corp. had previously made a tax election to currently deduct certain indirect overhead costs, starting with the 2002 tax return, that were capitalized for financial accounting purposes. This election allowed Avista Corp. to take tax deductions resulting in a total reduction of approximately $40 million in current tax liabilities for 2002, 2003 and 2004. These current tax benefits were deferred on the balance sheet in accordance with provisions of SFAS No. 109 and did not affect net income.

Due to the revenue ruling and related regulations, the IRS has disallowed the tax deduction of indirect overhead expenses during their exam of the Company's 2001, 2002 and 2003 federal income tax returns. The Company believes that the tax deductions claimed on tax returns were appropriate based on the applicable statutes and regulations in effect at the time. Avista Corp. appealed the proposed IRS adjustment on April 19, 2006. The Company's appeal has been received, but has not yet been scheduled for review by the IRS Appeals Division. The Company repaid a portion of the previous tax deductions through tax payments in 2005 and 2006. There can be no assurance that the Company's position will prevail. However, it is not expected to have a significant effect on the Company's net income.

The Company estimates that its liability for unrecognized tax benefits is $22.6 million at each of January 1, 2007 and March 31, 2007. With the adoption of FIN 48, this amount was reclassified from deferred income taxes to liability for unrecognized tax benefits. This liability primarily relates to the indirect overhead expenses described above, and the amount of this liability is included as other non-current liabilities and deferred credits on the Consolidated Balance Sheet as of March 31, 2007. The liability for unrecognized tax benefits would not affect the tax rate if recognized in 2007 as any adjustment to this tax item would be offset by an adjustment to current income tax expense. The liability for interest expense for unrecognized tax benefits as of January 1, 2007 was not material due to net operating loss and tax credit carryovers. The change in the liability for interest expense during the three months ended March 31, 2007 was not material. The Company has not accrued any penalties. The Company would recognize interest accrued related to income tax positions as interest expense and any penalties incurred as other operating expense.

**NOTE 9. SHORT-TERM BORROWINGS**

The Company has a committed line of credit agreement with various banks in the total amount of $320.0 million with an expiration date of April 5, 2011. Under the credit agreement, the Company can request the issuance of up to $320.0 million in letters of credit. The Company did not have any borrowings outstanding as of March 31, 2007 and $4.0 million of borrowings outstanding as of December 31, 2006. Total letters of credit outstanding were $45.3 million as of March 31, 2007 and $77.1 million as of December 31, 2006. The committed line of credit is secured by $320.0 million of non-transferable First Mortgage Bonds of the Company issued to the agent bank that would only become due and payable in the event, and then only to the extent, that the Company defaults on its obligations under the committed line of credit.

The committed line of credit agreement contains customary covenants and default provisions, including a covenant requiring the ratio of "earnings before interest, taxes, depreciation and amortization" to "interest expense" of Avista Utilities for the preceding twelve-month period at the end of any fiscal quarter to be greater than 1.6 to 1. As of March 31, 2007, the Company was in compliance with this covenant with a ratio of 2.45 to 1. The committed line of credit agreement also has a covenant which does not permit the ratio of "consolidated total debt" to "consolidated total capitalization" of Avista Corp. to be greater than 70 percent at the end of any fiscal quarter. This ratio limitation will be increased to 75 percent during the period between the completion of the proposed change in the Company's corporate organization (see Note 13) and December 31, 2007. As of March 31, 2007, the Company was in compliance with this covenant with a ratio of 53.1 percent. If the proposed change in organization becomes effective, the committed line of credit agreement will remain at Avista Corp.

Avista Energy and its subsidiary, Avista Energy Canada, as co-borrowers, have a committed credit agreement with a group of banks in the aggregate amount of $145.0 million with an expiration date of July 12, 2007. The Company expects that the Avista Energy credit agreement will be extended if necessary and terminated with the closing of the sale of Avista Energy's contracts and ongoing operations (see Note 3). This committed credit facility provides for the issuance of letters of credit to secure contractual obligations to counterparties and for cash advances. This facility is secured by the assets of Avista Energy and Avista Energy Canada and guaranteed by Avista Capital and by CoPac Management, Inc., a wholly owned subsidiary of Avista Energy Canada. The maximum amount of credit extended by the banks for the issuance of letters of credit is the subscribed amount of the facility less the amount of outstanding cash advances, if any. The maximum amount available for cash advances under the credit agreement is $50.0 million. No cash advances were outstanding as of March 31, 2007 and December 31, 2006. The total aggregate amount of letters of credit outstanding was $20.6 million as of March 31, 2007 and $52.5 million as of December 31, 2006. The cash deposits of Avista Energy at the respective banks collateralized $20.6 million and $24.9 million of these letters of credit as of March 31, 2007 and December 31, 2006, which is reflected as restricted cash on the Consolidated Balance Sheets.

The Avista Energy credit agreement contains covenants and default provisions, including covenants to maintain "minimum net working capital" and "minimum net worth," as well as a covenant limiting the amount of indebtedness

that the co-borrowers may incur. The credit agreement also contains covenants and other restrictions related to the co-borrowers' trading limits and positions, including VAR limits, restrictions with respect to changes in risk management policies or volumetric limits, and limits on exposure related to hourly and daily trading of electricity. These covenants, certain counterparty agreements and market liquidity conditions result in Avista Energy maintaining certain levels of cash and therefore effectively limit the amount of cash dividends that are available for distribution to Avista Capital and ultimately to Avista Corp. Avista Energy was in compliance with the covenants of its credit agreement as of March 31, 2007.

**NOTE 10. LONG-TERM DEBT**

The following details the interest rate and maturity dates of long-term debt outstanding as of March 31, 2007 and December 31, 2006 (dollars in thousands):

| Maturity Year | Description | Interest Rate | March 31, 2007 | December 31, 2006 |
|---|---|---|---|---|
| 2007 | Secured Medium-Term Notes | 5.99% | $ 13,850 | $ 13,850 |
| 2008 | Secured Medium-Term Notes | 6.06%-6.95% | 45,000 | 45,000 |
| 2010 | Secured Medium-Term Notes | 6.67%-8.02% | 35,000 | 35,000 |
| 2012 | Secured Medium-Term Notes | 7.37% | 7,000 | 7,000 |
| 2013 | First Mortgage Bonds | 6.13% | 45,000 | 45,000 |
| 2018 | Secured Medium-Term Notes | 7.39%-7.45% | 22,500 | 22,500 |
| 2019 | First Mortgage Bonds | 5.45% | 90,000 | 90,000 |
| 2023 | Secured Medium-Term Notes | 7.18%-7.54% | 13,500 | 13,500 |
| 2028 | Secured Medium-Term Notes | 6.37% | 25,000 | 25,000 |
| 2032 | Pollution Control Bonds | 5.00% | 66,700 | 66,700 |
| 2034 | Pollution Control Bonds | 5.13% | 17,000 | 17,000 |
| 2035 | First Mortgage Bonds | 6.25% | 150,000 | 150,000 |
| 2037 | First Mortgage Bonds | 5.70% | 150,000 | 150,000 |
| | Total secured long-term debt | | 680,550 | 680,550 |
| 2007 | Unsecured Medium-Term Notes | 7.90%-7.94% | — | 12,000 |
| 2008 | Unsecured Senior Notes | 9.75% | 272,860 | 272,860 |
| 2023 | Pollution Control Bonds | 6.00% | 4,100 | 4,100 |
| | Total unsecured long-term debt | | 276,960 | 288,960 |
| | Other long-term debt and capital leases | | 7,458 | 7,364 |
| | Interest rate swaps | | 1,051 | 1,037 |
| | Unamortized debt discount | | (1,359) | (1,452) |
| | Total | | 964,660 | 976,459 |
| | Current portion of long-term debt | | (14,607) | (26,605) |
| | Total long-term debt | | $950,053 | $ 949,854 |

**NOTE 11. EARNINGS PER COMMON SHARE**

The following table presents the computation of basic and diluted earnings per common share for the three months ended March 31 (in thousands, except per share amounts):

| | 2007 | 2006 |
|---|---|---|
| **Numerator:** | | |
| Net income | $14,094 | $31,572 |
| **Denominator:** | | |
| Weighted-average number of common shares outstanding-basic | 52,684 | 48,795 |
| Effect of dilutive securities: | | |
| Contingent stock awards | 275 | 212 |
| Stock options | 363 | 298 |
| Weighted-average number of common shares outstanding-diluted | 53,322 | 49,305 |
| Total earnings per common share, basic | $ 0.27 | $ 0.65 |
| Total earnings per common share, diluted | $ 0.26 | $ 0.64 |

Total stock options outstanding that were not included in the calculation of diluted earnings per common share were 26,200 for the three months ended March 31, 2007 and 446,500 for the three months ended March 31, 2006. These

stock options were excluded from the calculation because they were antidilutive based on the fact that the exercise price of the stock options was higher than the average market price of Avista Corp. common stock during the respective period.

**NOTE 12. COMMITMENTS AND CONTINGENCIES**

In the course of its business, the Company becomes involved in various claims, controversies, disputes and other contingent matters, including the items described in this Note. Some of these claims, controversies, disputes and other contingent matters involve litigation or other contested proceedings. With respect to these proceedings, the Company intends to vigorously protect and defend its interests and pursue its rights. However, no assurance can be given as to the ultimate outcome of any particular matter because litigation and other contested proceedings are inherently subject to numerous uncertainties. With respect to matters that affect Avista Utilities' operations, the Company intends to seek, to the extent appropriate, recovery of incurred costs through the rate making process. With respect to matters discussed in this Note that affect Avista Energy (particularly the California Refund Proceeding), any potential liabilities or refunds will remain at Avista Corp. and/or its subsidiaries and will not be assumed by Coral Energy and/or its affiliates.

***Federal Energy Regulatory Commission Inquiry***

On April 19, 2004, the FERC issued an order approving the contested Agreement in Resolution of Section 206 Proceeding (Agreement in Resolution) reached by Avista Corp. doing business as Avista Utilities, Avista Energy and the FERC's Trial Staff with respect to an investigation into the activities of Avista Utilities and Avista Energy in western energy markets during 2000 and 2001. In the Agreement in Resolution, the FERC Trial Staff stated that its investigation found: (1) no evidence that any executives or employees of Avista Utilities or Avista Energy knowingly engaged in or facilitated any improper trading strategy; (2) no evidence that Avista Utilities or Avista Energy engaged in any efforts to manipulate the western energy markets during 2000 and 2001; and (3) that Avista Utilities and Avista Energy did not withhold relevant information from the FERC's inquiry into the western energy markets for 2000 and 2001. In April 2005 and June 2005, the California Parties and the City of Tacoma, respectively, filed petitions for review of the FERC's decisions approving the Agreement in Resolution with the United States Court of Appeals for the Ninth Circuit. Based on the FERC's order approving the Agreement in Resolution and the FERC's denial of rehearing requests, the Company does not expect that this proceeding will have any material adverse effect on its financial condition, results of operations or cash flows.

***Class Action Securities Litigation***

On November 10, 2005, an amended class action complaint was filed in the United States District Court for the Eastern District of Washington against Avista Corp., Thomas M. Matthews, the former Chairman of the Board, President and Chief Executive Officer of Avista Corp., Gary G. Ely, the current Chairman of the Board and Chief Executive Officer of Avista Corp., and Jon E. Eliassen, the former Senior Vice President and Chief Financial Officer of Avista Corp. Several class action complaints were originally filed in September through November 2002 in the same court against the same parties. In February 2003, the court issued an order, which consolidated the complaints and in August 2003, the plaintiffs filed a consolidated amended class action complaint. On June 13, 2005, the Company filed a motion for reconsideration of its earlier motion to dismiss this complaint, based, in part, on a recent United States Supreme Court decision with respect to the pleading requirements surrounding a sufficient showing of loss causation. On October 19, 2005, the Court granted the Company's motion to dismiss this complaint. The order to dismiss was issued without prejudice, which allowed the plaintiffs to amend their complaint. The amended complaint filed on November 10, 2005 alleges damages due to the decrease in the total market value of the Company's common stock during the class period, alleged to be approximately $2.6 billion. These alleged losses stemmed from alleged violations of federal securities laws through alleged misstatements and omissions of material facts with respect to the Company's energy trading practices in western power markets. The plaintiffs assert that alleged misstatements and omissions regarding these matters were made in the Company's filings with the Securities and Exchange Commission and other information made publicly available by the Company, including press releases. The class action complaint asserts claims on behalf of all persons who purchased, converted, exchanged or otherwise acquired the Company's common stock during the period between November 23, 1999 and August 13, 2002. On January 6, 2006, the Company filed a motion to dismiss the November 10, 2005 complaint, asserting deficiencies in the amended complaint, including that the plaintiffs failed to adequately allege loss causation. On June 2, 2006, the U.S. District Court entered an order denying the Company's motion to dismiss the complaint. The U.S. District Court's order denying the Company's motion to dismiss is not a decision on the merits of the lawsuit. On September 16, 2006, the plaintiffs filed a motion for class certification. On February 13, 2007, the plaintiffs' motion for class certification was heard before the court. Also, pending before the court is defendants' motion for summary judgment seeking to dismiss plaintiffs' claims on the ground that they are barred by the applicable statute of limitations.

Because the resolution of this lawsuit remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that this lawsuit will have a material adverse effect on its financial condition, results of operations or cash flows.

***California Refund Proceeding***

With respect to Avista Energy, any potential liabilities or refunds regarding this proceeding will remain at Avista Corp. and/or its subsidiaries and will not be assumed by Coral Energy and/or its affiliates.

In July 2001, the FERC ordered an evidentiary hearing to determine the amount of refunds due to California energy buyers for purchases made in the spot markets operated by the California Independent System Operator (CalISO) and the California Power Exchange (CalPX) during the period from October 2, 2000 to June 20, 2001 (Refund Period) in the California spot power market. The findings of the FERC administrative law judge were largely adopted in March 2003 by the FERC. The refunds ordered are based on the development of a mitigated market clearing price methodology. If the refunds required by the formula would cause a seller to recover less than its actual costs for the Refund Period, the FERC has held that the seller would be allowed to document these costs and limit its refund liability commensurately. In September 2005, Avista Energy submitted its cost filing claim pursuant to the FERC's August 2005 order and demonstrated an overall revenue shortfall for sales into the California spot markets during the Refund Period after the mitigated market clearing price methodology is applied to its transactions. That filing was accepted in orders issued by the FERC in January 2006 and November 2006. In April 2007, the CalISO filed a status report with the FERC stating that it will take approximately seven weeks to complete the financial adjustment phase calculations for the Refund Period. In January 2007, Avista Energy joined in a settlement filed with the FERC by participants in markets operated by the Automated Power Exchange. The settlement was approved in March 2007.

In 2001, Pacific Gas & Electric (PG&E) and Southern California Edison (SCE) defaulted on payment obligations to the CalPX and the CalISO. As a result, the CalPX and the CalISO failed to pay various energy sellers, including Avista Energy. Both PG&E and the CalPX declared bankruptcy in 2001. In March 2002, SCE paid its defaulted obligations to the CalPX. In April 2004, PG&E paid its defaulted obligations into an escrow fund in accordance with its bankruptcy reorganization. Funds held by the CalPX and in the PG&E escrow fund are not subject to release until the FERC issues an order directing such release in the California refund proceeding. As of March 31, 2007, Avista Energy's accounts receivable outstanding related to defaulting parties in California were fully offset by reserves for uncollected amounts and funds collected from defaulting parties.

In addition, in June 2003, the FERC issued an order to review bids above $250 per MW made by participants in the short-term energy markets operated by the CalISO and the CalPX from May 1, 2000 to October 2, 2000. In May 2004, the FERC provided notice that Avista Energy was no longer subject to this investigation. In March and April 2005, the California Parties and PG&E, respectively, petitioned for review of the FERC's decision by the United States Court of Appeals for the Ninth Circuit. In addition, many of the other orders that the FERC has issued in the California refund proceedings are now on appeal before the Ninth Circuit. Some of those issues have been consolidated as a result of a case management conference conducted in September 2004. In October 2004, the Ninth Circuit ordered that briefing proceed in two rounds. The first round is limited to three issues: (1) which parties are subject to the FERC's refund jurisdiction in light of the exemption for government-owned utilities in section 201(f) of the Federal Power Act (FPA); (2) the temporal scope of refunds under section 206 of the FPA; and (3) which categories of transactions are subject to refunds. In September 2005, the Ninth Circuit held that the FERC did not have the authority to order refunds for sales made by municipal utilities in the California Refund Case. In August 2006, the Ninth Circuit upheld October 2, 2000 as the refund effective date for the FPA section 206 Refund Proceeding, but remanded to the FERC its decision not to consider a FPA section 309 remedy for tariff violations prior to October 2, 2000. The Ninth Circuit also granted California's petition for review challenging the FERC's exclusion of the energy exchange transactions as well as the FERC's exclusion of forward market transactions from the California refund proceedings. The Ninth Circuit has extended until June 13, 2007, the time for filing petitions for rehearing. It is unclear at this time what impact, if any, the Court's remand might have on Avista Energy. The second round of issues and their corresponding briefing schedules have not yet been set by the Ninth Circuit Court of Appeals.

Because the resolution of the California refund proceeding remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that the California refund proceeding will have a material adverse effect on its financial condition, results of operations or cash flows. This is primarily due to the fact that FERC orders have stated that any refunds will be netted against unpaid amounts owed to the respective parties and the Company does not believe that refunds would exceed unpaid amounts owed to the Company.

***Pacific Northwest Refund Proceeding***

In July 2001, the FERC initiated a preliminary evidentiary hearing to develop a factual record as to whether prices for spot market sales in the Pacific Northwest between December 25, 2000 and June 20, 2001 were just and reasonable. During the hearing, Avista Utilities and Avista Energy vigorously opposed claims that rates for spot market sales were unjust and unreasonable and that the imposition of refunds would be appropriate. In June 2003, the FERC terminated the Pacific Northwest refund proceedings, after finding that the equities do not justify the imposition of refunds. Seven petitions for review, including one filed by Puget Sound Energy, Inc. (Puget), are now pending before the United States Court of Appeals for the Ninth Circuit. Opening briefs were filed in January 2005. Petitioners other than Puget challenged the merits of the FERC's decision not to order refunds. Puget's brief is directed to the procedural flaws in the underlying docket. Puget argues that because its complaint was withdrawn as a matter of law in July 2001, the FERC erred in relying on it to serve as the basis to initiate the preliminary investigation into whether refunds for individually negotiated bilateral transactions in the Pacific Northwest were appropriate. In February 2005, intervening parties, including Avista Energy and Avista Utilities, filed in support of Puget and also filed in opposition to the other six petitioners. Briefing was completed in May 2005 and oral arguments were heard on January 8, 2007. Because the resolution of the Pacific Northwest refund proceeding remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that the Pacific Northwest refund proceeding will have a material adverse effect on its financial condition, results of operations or cash flows.

***California Attorney General Complaint***

In May 2002, the FERC conditionally dismissed a complaint filed in March 2002 by the Attorney General of the State of California (California AG) that alleged violations of the Federal Power Act by the FERC and all sellers (including Avista Corp. and its subsidiaries) of electric power and energy into California. The complaint alleged that the FERC's adoption and implementation of market-based rate authority was flawed and, as a result, individual sellers should refund the difference between the rate charged and a just and reasonable rate. In May 2002, the FERC issued an order dismissing the complaint but directing sellers to re-file certain transaction summaries. It was not clear that Avista Corp. and its subsidiaries were subject to this directive but the Company took the conservative approach and re-filed certain transaction summaries in June and July of 2002. In July 2002, the California AG requested a rehearing on the FERC order, which request was denied in September 2002. Subsequently, the California AG filed a Petition for Review of the FERC's decision with the United States Court of Appeals for the Ninth Circuit. In September 2004, the United States Court of Appeals for the Ninth Circuit upheld the FERC's market-based rate authority, but found the requirement that all sales at market-based rates be contained in quarterly reports filed with the FERC to be integral to a market-based rate tariff. The California AG has interpreted the decision as providing authority to the FERC to order refunds in the California refund proceeding for an expanded refund period. The Court's decision leaves to the FERC the determination as to whether refunds are appropriate. In October 2004, Avista Energy joined with others in seeking rehearing of the Court's decision to remand the case back to the FERC for further proceedings. The Court denied the request without explanation on July 31, 2006. The Ninth Circuit has stayed the mandate in this case until June 13, 2007. On December 28, 2006 certain parties filed a petition for a writ of certiorari at the Supreme Court, which is currently pending. The California AG responded to that petition on February 5, 2007 and filed its own conditional cross-petition for a writ of certiorari. The FERC opposed the petition for a writ of certiorari and the cross-petition in April 2007. Based on information currently known to the Company's management, the Company does not expect that this matter will have a material adverse effect on its financial condition, results of operations or cash flows.

***Wah Chang Complaint***

In May 2004, Wah Chang, a division of TDY Industries, Inc. (a subsidiary of Allegheny Technologies, Inc.), filed a complaint in the United States District Court for the District of Oregon against numerous companies, including Avista Corp., Avista Energy and Avista Power. This complaint is similar to the Port of Seattle complaint (which was dismissed by the United States District Court and the United States Court of Appeals for the Ninth Circuit as disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006) and seeks compensatory and treble damages for alleged violations of the Sherman Act, the Racketeer Influenced and Corrupt Organization Act, as well as violations of Oregon state law. According to the complaint, from September 1997 to September 2002, the plaintiff purchased electricity from PacifiCorp pursuant to a contract that was indexed to the spot wholesale market price of electricity. The plaintiff alleges that the defendants, acting in concert among themselves and/or with Enron Corporation and certain affiliates thereof (collectively, Enron) and others, engaged in

a scheme to defraud electricity customers by transmitting false market information in interstate commerce in order to artificially increase the price of electricity provided by them, to receive payment for services not provided by them and to otherwise manipulate the market price of electricity, and by executing wash trades and other forms of market manipulation techniques and sham transactions. The plaintiff also alleges that the defendants, acting in concert among themselves and/or with Enron and others, engaged in numerous practices involving the generation, purchase, sale, exchange, scheduling and/or transmission of electricity with the purpose and effect of causing a shortage (or the appearance of a shortage) in the generation of electricity and congestion (or the appearance of congestion) in the transmission of electricity, with the ultimate purpose and effect of artificially and illegally fixing and raising the price of electricity in California and throughout the Pacific Northwest. As a result of the defendants' alleged conduct, the plaintiff allegedly suffered damages of not less than $30 million through the payment of higher electricity prices. In September 2004, this case was transferred to the United States District Court for the Southern District of California for consolidation with other pending actions. In February 2005, the Court granted the defendants' motion to dismiss the complaint because it determined that it was without jurisdiction to hear the plaintiff's complaint, based on, among other things, the exclusive jurisdiction of the FERC and the filed-rate doctrine. In March 2005, Wah Chang filed an appeal with the United States Court of Appeals for the Ninth Circuit. The appeal of Wah Chang is still pending before the Ninth Circuit and oral arguments were heard on April 10, 2007. Because the resolution of this lawsuit remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that this lawsuit will have a material adverse effect on its financial condition, results of operations or cash flows.

***City of Tacoma Complaint***

In June 2004, the City of Tacoma, Department of Public Utilities, Light Division, a Washington municipal corporation (Tacoma Power), filed a complaint in the United States District Court for the Western District of Washington against over fifty companies, including Avista Corp., Avista Energy and Avista Power. According to the complaint, Tacoma Power distributes electricity to customers in Tacoma, and Pierce County, Washington, generates electricity at several facilities in western Washington and purchases power under supply contracts and in the Northwest spot market. Tacoma Power's complaint was similar to the Port of Seattle complaint (which was dismissed by the United States District Court and the United States Court of Appeals for the Ninth Circuit as disclosed in the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006) and seeks compensatory and treble damages from alleged violations of the Sherman Act. Tacoma Power alleged that the defendants, acting in concert, engaged in a pattern of activities that had the purpose and effect of creating the impressions that the demand for power was higher, the supply of power was lower, or both, than was in fact the case. This allegedly resulted in an artificial increase of the prices paid for power sold in California and elsewhere in the western United States during the period from May 2000 through the end of 2001. Due to the alleged unlawful conduct of the defendants, Tacoma Power allegedly paid an amount estimated to be $175.0 million in excess of what it would have paid in the absence of such alleged conduct. In September 2004, this case was transferred to the United States District Court for the Southern District of California for consolidation with other pending actions. In February 2005, the Court granted the defendants' motion to dismiss this complaint for similar reasons to those expressed by the Court in the Wah Chang complaint described above. In March 2005, Tacoma Power filed an appeal with the United States Court of Appeals for the Ninth Circuit. In March 2007, the Ninth Circuit approved a Stipulation of Dismissal of the appeal, thus ending Tacoma Power's complaint.

***State of Montana Proceedings***

In June 2003, the Attorney General of the State of Montana (Montana AG) filed a complaint in the Montana District Court on behalf of the people of Montana and the Flathead Electric Cooperative, Inc. against numerous companies, including Avista Corp. The complaint alleges that the companies illegally manipulated western electric and natural gas markets in 2000 and 2001. This case was subsequently moved to the United States District Court for the District of Montana; however, it has since been remanded back to the Montana District Court.

The Montana AG also petitioned the Montana Public Service Commission (MPSC) to fine public utilities $1,000 a day for each day it finds they engaged in alleged "deceptive, fraudulent, anticompetitive or abusive practices" and order refunds when consumers were forced to pay more than just and reasonable rates. In February 2004, the MPSC issued an order initiating investigation of the Montana retail electricity market for the purpose of determining whether there is evidence of unlawful manipulation of that market. The Montana AG has requested specific information from Avista Energy and Avista Corp. regarding their transactions within the state of Montana during the period from January 1, 2000 through December 31, 2001.

Because the resolution of these proceedings remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that these proceedings will have a material adverse effect on its financial condition, results of operations or cash flows.

***Montana Public School Trust Fund Lawsuit***

In October 2003, a lawsuit was originally filed by two residents of the state of Montana in the United States District Court for the District of Montana against all private owners of hydroelectric dams in Montana, including Avista Corp. The lawsuit alleged that the hydroelectric facilities are located on state-owned riverbeds and the owners of the dams have never paid compensation to the state's public school trust fund. The lawsuit requests lease payments dating back to the construction of the respective dams and also requests damages for trespassing and unjust enrichment. In February 2004, the Company filed its motion to dismiss this lawsuit; PacifiCorp and PPL Montana, the other named defendants, also filed a motion to dismiss, or joined therein. In May 2004, the Montana AG filed a complaint on behalf of the state in the District Court to join in this lawsuit to allegedly protect and preserve state lands/school trust lands from use without compensation. In July 2004, the defendants (including Avista Corp.) filed a motion to dismiss the Montana AG's complaint. In September 2004, the motion to dismiss the Montana AG's complaint was denied, rejecting the defendants' argument, among other things, that the FERC has exclusive jurisdiction over this matter. In September 2005, the U.S. District Court issued an order vacating its prior decision based on lack of jurisdiction.

In November 2004, the defendants (including Avista Corp.) filed a petition for declaratory relief in Montana State Court requesting the resolution of the claim that the plaintiffs raised in federal court, as discussed above, and the Montana AG filed an answer, counterclaim and motion for summary judgment. In June 2005, Avista Corp. moved for leave to amend its complaint to, inter alia, add two causes of action relating to breach of contract and negligent misrepresentation arising out of its Clark Fork Settlement Agreement that was entered into in 1999 with the state of Montana relating to the relicensing of Avista Corp.'s Noxon Rapids Hydroelectric Generating Project. On April 14, 2006, the Montana State Court granted the Montana AG's motion for summary judgment and denied Avista Corp.'s motion to amend its complaint to add its breach of contract and negligent misrepresentation claims. However, the Montana State Court granted Avista Corp.'s motion to amend its complaint to contend that the Clark Fork River is not navigable. The Company contends that if the Clark Fork River was not navigable at the time of statehood in 1889, the state of Montana never acquired ownership of the riverbeds under the equal footing doctrine. The Court determined that the Montana AG's claims for compensation were not preempted by the Federal Power Act because the claims were not, on their face, in conflict with Montana law, nor were they preempted by a federal navigational right for purposes of interstate commerce. The Court also rejected defenses based on estoppel, waiver, and the statute of limitations. The Court did not relieve the Montana AG, however, of its obligation to prove that the state of Montana actually owns the riverbeds or that the land is part of a school trust under the Montana Constitution. In addition, the question of whether there is federal preemption under the Federal Power Act, not on its face, but as actually applied in these circumstances, and the question of compensation, still remain open issues in the case. On May 16, 2006, the state of Montana filed a motion for summary judgment on the question of liability. On October 6, 2006, the Company filed several motions, which addressed, among other things, the question of navigability of the Clark Fork River arguing that since the Clark Fork River was not navigable at the time of statehood, the state of Montana never acquired ownership of the riverbeds under the equal footing doctrine. Oral arguments on the Company's motions were heard in December 2006. The Company expects this matter to proceed in the normal course of litigation and a trial date is currently scheduled for October 2007. Because the resolution of this lawsuit remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, the Company intends to seek recovery, through the rate making process, of any amounts paid.

***Colstrip Generating Project Complaints***

In May 2003, various parties (all of which are residents or businesses of Colstrip, Montana) filed a consolidated complaint against the owners of the Colstrip Generating Project (Colstrip) in Montana District Court. Avista Corp. owns a 15 percent interest in Units 3 & 4 of Colstrip. The plaintiffs allege damages to buildings as a result of rising ground water, as well as damages from contaminated waters leaking from the lakes and ponds of Colstrip. The plaintiffs are seeking punitive damages, an order by the court to remove the lakes and ponds and the forfeiture of all profits earned from the generation of Colstrip. The owners of Colstrip have undertaken certain groundwater investigation and remediation measures to address groundwater contamination. These measures include improvements to the lakes and ponds of Colstrip. The Company intends to continue to work with the other owners of Colstrip in defense of this complaint. Because the resolution of this lawsuit remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. However, based on information currently known to the Company's management, the Company does not expect that this lawsuit will have a material adverse effect on its financial condition, results of operations or cash flows.

In March 2007, a group of ranchers filed a consolidated complaint against the owners of Colstrip in Montana District Court. The plaintiffs allege damages to livestock, land and water from contaminated waters leaking from the waste water pond of Colstrip. The plaintiffs are seeking unspecified punitive damages. The Company intends to work with the other owners of Colstrip to defend this complaint. There is currently not enough information to allow the Company to assess the probability or amount of a liability, if any, being incurred.

***Environmental Protection Agency Administrative Compliance Order***

In December 2003, PPL Montana, LLC, as operator of Colstrip, received an Administrative Compliance Order (ACO) from the Environmental Protection Agency (EPA) pursuant to the Clean Air Act (CAA). The ACO alleged that Colstrip Units 3 & 4 have been in violation of the CAA permit at Colstrip since the units came on-line in the 1980s. The permit required the Colstrip project operator to submit for review and approval by the EPA, an analysis and proposal for reducing emissions of nitrogen oxides to address visibility concerns if, and when, EPA promulgates Best Available Retrofit Technology requirements for nitrogen oxide emissions. The EPA asserted that regulations it promulgated in 1980 triggered this requirement. In March 2007, the owners of Colstrip finalized a settlement agreement with the EPA, the Department of Environmental Quality (Montana DEQ) and the Northern Cheyenne Tribe. The settlement agreement resolves the potential liability related to this issue and will result in the installation of additional nitrogen oxide emissions control equipment at Colstrip. The Company's share of the total costs related to the settlement agreement is not material to the Company's financial condition or results of operations.

***Colstrip Royalty Claim***

Western Energy Company (WECO) supplies coal to the owners of Colstrip Units 3 & 4 under a Coal Supply Agreement and a Transportation Agreement. Avista Corp. owns a 15 percent interest in Colstrip Units 3 & 4. The Minerals Management Service (MMS) of the United States Department of the Interior issued an order to WECO to pay additional royalties concerning coal delivered to Colstrip Units 3 & 4 via the conveyor belt (4.46 miles long). The owners of Colstrip Units 3 & 4 take delivery of the coal at the beginning of the conveyor belt. The order asserts that additional royalties are owed MMS as a result of WECO not paying royalties in connection with revenue received by WECO from the owners of Colstrip Units 3 & 4 under the Transportation Agreement during the period October 1, 1991 through December 31, 2001. WECO's appeal to the MMS was substantially denied in March 2005; WECO has now appealed the order to the Board of Land Appeals of the U.S. Department of the Interior. The entire appeal process could take several years to resolve. The owners of Colstrip Units 3 & 4 are monitoring the appeal process between WECO and MMS. WECO has indicated to the owners of Colstrip Units 3 & 4 that if WECO is unsuccessful in the appeal process, WECO will seek reimbursement of any royalty payments by passing these costs through the Coal Supply Agreement. The owners of Colstrip Units 3 & 4 advised WECO that their position would be that these claims are not allowable costs per the Coal Supply Agreement nor the Transportation Agreement in the event the owners of Colstrip Units 3 & 4 were invoiced for these claims. Presumably, royalty and tax demands for periods of time after the years in dispute and future years will be determined by the outcome of the pending proceedings. Because the resolution of this issue remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability. Based on information currently known to the Company's management, the Company does not expect that this issue will have a material adverse effect on its financial condition, results of operations or cash flows. However, the Company would most likely seek recovery, through the rate making process, of any amounts paid.

***Spokane River***

The Company has entered into a settlement with the state of Washington's Department of Ecology (DOE) and Kaiser Aluminum & Chemical Corporation (Kaiser) relating to the remediation of a contaminated site on the Spokane River. The Company's involvement with this contaminated site relates to its previous ownership of a wastewater treatment plant through Avista Development. Under the agreement with the DOE and Kaiser, the Company is performing the selected remedial action under the Cleanup Action Plan. Kaiser, operating under Chapter 11 bankruptcy protection, paid the Company approximately 50 percent of the estimated total costs, which was approved by the Kaiser bankruptcy judge. The funds from Kaiser have been used by the Company to pay a portion of the costs of the remediation. The Company accrued its share of the total estimated costs, which was not material to the Company's financial condition or results of operations. Under the direction of the Company, work under the Cleanup Action Plan was substantially completed by January 2007. Final work should be completed in the second quarter of 2007. Because of uncertainties with respect to, among other things, unforeseen site conditions, the Company's estimate of its liability could change in future periods. Based on information currently known to the Company's management, the Company does not believe that such a change would be material to its financial condition, results of operations or cash flows.

***Northeast Combustion Turbine Site***

In August 2005, a diesel fuel spill occurred at the Company's Northeast Combustion Turbine generating facility (Northeast CT) located in Spokane, Washington. The Northeast CT site had fuel storage facilities that were leased to Co-op Supply, Inc., an affiliate of Cenex Cooperative (Co-op). The fuel spill occurred when Co-op made a delivery of diesel to a tank that was already nearly full, causing excess fuel to overflow into a containment area. It is estimated that approximately 26,000 gallons of fuel escaped the containment area and leaked into the soil below it. An investigation, supervised by the DOE, determined the fuel was, for the most part, uniformly present in the soil to a depth of 30-35 feet. Groundwater below the site is at a depth of 170 feet. The Company immediately commenced remediation efforts, including the removal of contaminated soil and the related fuel storage facilities. The Company accrued the estimated cleanup costs during 2005, which was not material to the Company's consolidated financial condition or results of operations. During the fourth quarter of 2005, the Company filed a complaint against Co-op and an engineering firm to recover a substantial portion of the cleanup costs. Through mediation the Company recovered a substantial portion of the cleanup costs from Co-op and the engineering firm in the fourth quarter of 2006. The Company's estimate of its liability could change in future periods. Based on information currently known to the Company's management, the Company does not believe that such a change would be material to its financial condition, results of operations or cash flows.

***Harbor Oil Inc. Site***

Avista Corp. used Harbor Oil Inc. (Harbor Oil) for the recycling of waste oil and non-PCB transformer oil in the late 1980s and early 1990s. In June 2005, EPA Region 10 provided notification to Avista Corp., as a customer of Harbor Oil, that the EPA had determined that hazardous substances were released at the Harbor Oil site in Portland, Oregon and that Avista Corp. may be liable for investigation and cleanup of the site under the Comprehensive Environmental Response, Compensation, and Liability Act, commonly referred to as the federal "Superfund" law. Harbor Oil's primary business was the collection and blending of used oil for sale as fuel to ships at sea. The initial indication from the EPA is that the site may be contaminated with PCBs, petroleum hydrocarbons, chlorinated solvents and heavy metals. Thirteen other companies received a similar notice, including current and former owners of the site, the Bonneville Power Administration, Portland General Electric Company, Northwestern Energy and Unocal Oil. Several meetings have been held with the EPA and certain of the Potentially Responsible Parties (PRPs) to ask questions of the EPA regarding the Harbor Oil site, as well as drafting an administrative compliance order related to conducting a remedial investigation and feasibility study for the site. The Company intends to fund a share of a remedial investigation and feasibility study of the site, which is not expected to be material to its financial condition or results of operations. Based on the review of its records related to Harbor Oil, the Company does not believe it is a major contributor to this potential environmental contamination based on the relative volume of waste oil delivered to the Harbor Oil site. However, there is currently not enough information to allow the Company to assess the probability or amount of a liability, if any, being incurred. As such, it is not possible to make an estimate of any liability at this time.

***Lake Coeur d'Alene***

In July 1998, the United States District Court for the District of Idaho issued its finding that the Coeur d'Alene Tribe of Idaho (Tribe) owns, among other things, portions of the bed and banks of Lake Coeur d'Alene (Lake) lying within the current boundaries of the Coeur d'Alene Reservation. This action had been brought by the United States on behalf of the Tribe against the state of Idaho. The Company was not a party to this action. The United States District Court decision was affirmed by the United States Court of Appeals for the Ninth Circuit. The United States Supreme Court affirmed this decision in June 2001. This ownership decision will result in, among other things, the Company being liable to the Tribe for compensation for the use of reservation lands under Section 10(e) of the Federal Power Act.

The Company's Post Falls Hydroelectric Generating Station (Post Falls), a facility constructed in 1906 with annual generation of 10 aMW, utilizes a dam on the Spokane River downstream of the Lake which controls the water level in the Lake for portions of the year (including portions of the lakebed owned by the Tribe). The Company has other hydroelectric facilities on the Spokane River downstream of Post Falls, but these facilities do not affect the water level in the Lake. The Company and the Tribe are engaged in discussions related to past and future compensation (which may include interest) for use of the portions of the bed and banks of the Lake, which are owned by the Tribe. If the parties cannot agree on the amount of compensation, the matter could result in litigation. The Company cannot predict the amount of compensation that it will ultimately pay or the terms of such payment. The Company intends to seek recovery, through the rate making process, of any amounts paid.

***Spokane River Relicensing***

The Company owns and operates six hydroelectric plants on the Spokane River, and five of these (Long Lake, Nine Mile, Upper Falls, Monroe Street and Post Falls, which have a total present capability of 155.7 MW) are under one FERC license and are referred to as the Spokane River Project. The sixth, Little Falls, is operated under separate Congressional authority and is not licensed by the FERC. The license for the Spokane River Project expires on August 1, 2007; the Company filed a Notice of Intent to Relicense in July 2002. The formal consultation process involving planning and information gathering with stakeholder groups has been underway since that time. The Company filed its new license applications with the FERC in July 2005. The Company has requested the FERC to consider a license for Post Falls, which has a present capability of 18 MW, that is separate from the other four hydroelectric plants because Post Falls presents more complex issues that may take longer to resolve than those dealing with the rest of the Spokane River Project. If granted, new licenses would have a term of 30 to 50 years. In the license applications, the Company proposed a number of measures intended to address the impact of the Spokane River Project and enhance resources associated with the Spokane River.

Since the Company's July 2005 filing of applications to relicense the Spokane River Project, the FERC has continued various stages of processing the applications. In May 2006, the FERC issued a notice calling for terms and conditions regarding the two license applications. In response to that notice, a number of parties (including the Coeur d'Alene Tribe, the state of Idaho, Washington State agencies, and the United States Department of Interior (DOI)) filed either recommended terms and conditions, pursuant to Sections 10(a) and 10(j) of the Federal Power Act (FPA), or mandatory conditions related to the Post Falls application, pursuant to Section 4(e) of the FPA. The Company's initial estimate of the potential cost of the conditions proposed for Post Falls total between $400 million and $500 million over a 50-year period. This assumes all conditions, both mandatory and recommended, as well as the Company's proposed conditions, would be included in a final license issued by the FERC, which the Company believes to be unlikely. For the rest of the Spokane River Project, which is located in Washington, the Company's initial estimate of the cost of meeting the recommended conditions, should they be included in a final license, totals between $175 million and $225 million over a 50-year period. These cost estimates are based on the preliminary conditions and recommendations and will be updated based on the outcome of the FERC proceedings.

The Company requested a trial-type hearing on facts in front of an Administrative Law Judge (ALJ) related to the DOI's mandatory conditions for Post Falls. In January 2007, the ALJ issued his ruling regarding the Company's challenge of the facts. The Company believes that the ALJ's factual findings support, in several key areas, its analysis of the facts at hand. The ALJ's factual findings also support the DOI's analysis in certain areas as well.

The Bureau of Indian Affairs, which is part of the DOI and is charged with protecting project-related resources on the Coeur d'Alene Indian Reservation and has authority to set conditions for the Company's license, is now expected to use the ALJ's findings to formulate final mandatory conditions for the operation of Post Falls. The DOI is expected to issue final mandatory conditions by May 7, 2007.

The broader relicensing process continues under the jurisdiction of the FERC. The FERC issued a draft environmental impact statement (DEIS) in December 2006 that was open for public review and comment through March 6, 2007. The DEIS includes the FERC's initial analysis of the applications, along with analysis of proposed recommended and mandatory terms and conditions. Many parties, including resource agencies and Tribes, commented to the FERC regarding the DEIS, as did Avista Corp. The Company also filed reply comments regarding the comments that the FERC received from other parties. The FERC will prepare a Final Environmental Impact Statement (FEIS) after review and consideration of comments. The Company cannot predict the schedule for the issuance of the FEIS. While the FERC's draft analysis leads the Company to believe the ultimate cost of relicensing may be less than its earlier projections as disclosed above, the Company is unable to base specific new cost estimates on this analysis.

The relicensing process also triggers review under the Endangered Species Act. In the DEIS, the FERC analyzed potential project impacts on listed and threatened endangered species, and has determined that the proposed action and continued operation of the Post Falls and Spokane River projects, is not likely to adversely affect any threatened or endangered species. The Company prepared a draft Biological Assessment in 2005. The FERC has issued a Biological Assessment and formally requested concurrence from the United States Department of Fish and Wildlife Service (USFWS). The USFWS responded by letter, concurring with regards to bald eagles, and requesting additional information regarding bull trout. The Company has filed a supplemental report to address the USFWS information request. If the FERC initiates formal consultation with the USFWS, additional evaluation will be required by the Company.

In addition, the Company must receive Clean Water Act Certifications from the states of Idaho and Washington for

the Projects. Applications for such certification were filed last July with each state; the FERC is precluded from issuing a license order until such certification has been issued, or waived, by the states. The Company cannot predict the schedule for these final phases of relicensing.

If the FERC is unable to issue new license orders prior to the August 1, 2007 expiration of the current license, an annual license will be issued, in effect extending the current license and its conditions. The Company has no reason to believe that Spokane River Project operations would be interrupted in any manner relative to the timing of the FERC's actions.

The total annual operating and capitalized costs associated with the relicensing of the Spokane River Project will become better known and estimable as the process continues. The Company intends to seek recovery, through the rate making process, of all such operating and capitalized costs.

***Clark Fork Settlement Agreement***

Dissolved atmospheric gas levels exceed state of Idaho and federal water quality standards downstream of the Cabinet Gorge Hydroelectric Generating Project (Cabinet Gorge) during periods when excess river flows must be diverted over the spillway. Under the terms of the Clark Fork Settlement Agreement, the Company developed an abatement and mitigation strategy with the other signatories to the agreement and completed the Gas Supersaturation Control Program (GSCP). The Idaho Department of Environmental Quality and the USFWS approved the GSCP in February 2004 and the FERC issued an order approving the GSCP in January 2005.

The GSCP provides for the opening and modification of one and, potentially, both of the two existing diversion tunnels built when Cabinet Gorge was originally constructed. When river flows exceed the capacity of the powerhouse turbines, the excess flows would be diverted to the tunnels rather than released over the spillway. The Company has undertaken physical and computer modeling studies to confirm the feasibility and likely effectiveness of its tunnel solution. The Company has completed its preliminary design development efforts (which include additional computer model studies, some site investigation, and preliminary engineering design) and the cost estimates have been updated. Analysis of the predicted total dissolved gas (TDG) performance indicates that the tunnels are unlikely to meet the performance criteria anticipated in the GSCP. The costs of modifying the first tunnel are now estimated to be $58 million (using 2006 dollars with inflation projected at 5 percent) with the majority of these costs to be incurred in 2008 through 2012, an increase from prior estimates of $38 million and an extension of the schedule. The calculated updated cost estimates to modify the second tunnel are $39 million, an increase from prior estimates of $26 million. The second tunnel would be modified only after evaluation of the performance of the first tunnel and such modifications would commence no later than ten years following the completion of the first tunnel. The increases in costs are mainly due to inflation and large increases in materials costs, such as concrete and steel. Efforts will continue throughout 2007 toward the completion of a final Design Development Report, which will include updated tunnel performance predictions, cost estimates, and schedule. As a result of the predicted TDG performance, the new cost estimates and extension of the schedule, the Company will continue meeting with stakeholders to explore amending the GSCP and possible alternatives to the construction of the tunnels. The Company intends to seek recovery, through the rate making process, of the costs to address the dissolved atmospheric gas levels, including the mitigation payments.

The USFWS has listed bull trout as threatened under the Endangered Species Act. The Clark Fork Settlement Agreement describes programs intended to restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, the Company is evaluating the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies will help the Company and other parties determine the best use of funds toward continuing fish passage efforts or other bull trout population enhancement measures.

***Air Quality***

The Company must be in compliance with requirements under the Clean Air Act and Clean Air Act Amendments for its thermal generating plants. The Company continues to monitor legislative developments at both the state and national level for the potential of further restrictions on sulfur dioxide, nitrogen oxide, carbon dioxide (including cap and trade emission reduction programs), as well as other greenhouse gas and mercury emissions.

In particular, the EPA has finalized mercury emission regulations that will affect coal-fired generation plants, including Colstrip. The new EPA regulations establish an emission trading program to take effect beginning in January 2010, with a second phase to take effect in 2018. In addition, in 2006, the Montana DEQ adopted final rules for the control of mercury emissions from coal-fired plants that are more restrictive than EPA regulations. The new rules set strict mercury emission limits by 2010, and put in place a recurring ten-year review process to ensure

facilities are keeping pace with advancing technology in mercury emission control. The rules also provide for temporary alternate emission limits provided certain provisions are met, and they allocate mercury emission credits in a manner that rewards the cleanest facilities. Avista Corp. owns a 15 percent interest in Colstrip Units 3 & 4, located in Montana.

Compliance with these new and proposed requirements and possible additional legislation or regulations will result in increases to capital expenditures and operating expenses for expanded emission controls at the Company's thermal generating facilities. The Company, along with the other owners of Colstrip, are in the process of computing estimates for the amount of these costs and the impact the restrictions will have on the operation of the facilities. The Company will continue to seek recovery, through the rate making process, of the costs to comply with various air quality requirements.

***Residential Exchange Program***

The Residential Exchange Program provides access to the benefits of low-cost federal hydroelectricity to residential and small-farm customers of the region's investor-owned utilities. The Bonneville Power Administration (BPA) administers the Residential Exchange Program. Avista Corp. has executed an agreement with the BPA in settlement of each party's rights and obligations related to the Residential Exchange Program for the period October 1, 2001 through September 30, 2011. The benefits that Avista Corp. receives under the agreement with the BPA are passed through directly to its residential and small-farm customers via a credit to their monthly electric bills. The current BPA rate period covers the second five years of the ten-year agreement, which began on October 1, 2006 and continues through September 30, 2011. Numerous parties filed Petitions for Review in the Ninth Circuit Court of Appeals challenging the agreements between Avista Corp. and the BPA, as well as the BPA's agreements with other investor-owned utilities. On May 3, 2007, the Ninth Circuit Court of Appeals ruled that the settlement agreements entered into between the BPA and investor-owned utilities (including Avista Corp.) are inconsistent with the Northwest Power Act. The Company and the BPA are evaluating the impact this ruling will have on the Residential Exchange Program. Since these benefits are passed through to Avista Corp.'s customers as adjustments to electric rates, which must be approved by the WUTC and the IPUC, the ruling by the Ninth Circuit Court of Appeals is not expected to have a significant effect on the Company's financial condition or results of operations. However, there is currently not enough information to allow the Company to assess the probability or amount of a liability, if any, being incurred.

***Other Contingencies***

In the normal course of business, the Company has various other legal claims and contingent matters outstanding. The Company believes that any ultimate liability arising from these actions will not have a material adverse impact on its financial condition, results of operations or cash flows. It is possible that a change could occur in the Company's estimates of the probability or amount of a liability being incurred. Such a change, should it occur, could be significant.

**NOTE 13. POTENTIAL HOLDING COMPANY FORMATION**

At the 2006 Annual Meeting of Shareholders in May 2006, the shareholders of Avista Corp. approved a proposal to proceed with a statutory share exchange, which would change the Company's organization to a holding company structure. The holding company, currently named AVA Formation Corp. (AVA), would become the parent of Avista Corp. After the contemplated dividend to AVA of the capital stock of Avista Capital (Avista Capital Dividend) now held by Avista Corp., AVA would then also be the parent of Avista Capital. The Avista Capital Dividend would effect the structural separation of Avista Corp.'s non-utility businesses from its regulated utility business. Since the company's 9.75 percent Senior Notes due June 1, 2008 contain a restriction that would prohibit the Avista Capital Dividend (but not the holding company structure), the dividend would not be distributed until the Senior Notes are retired.

Avista Corp. received approval from the FERC in April 2006 (conditioned on approval by the state regulatory agencies), the IPUC in June 2006 and the WUTC in February 2007. Avista Corp. has also filed for approval from the utility regulators in Oregon and Montana. The statutory share exchange is subject to the receipt of the remaining regulatory approvals and the satisfaction of other conditions. If the statutory share exchange and the implementation of the holding company structure are approved by regulators on terms acceptable to the Company, it may be completed sometime after mid-2007.

The IPUC accepted a stipulation entered into between Avista Corp. and the IPUC Staff that sets forth a variety of conditions, which would serve to segregate the Company's utility operations from the other businesses conducted by the holding company. The stipulation would require Avista Corp. to maintain certain common equity levels as part of its capital structure. Avista Corp. has committed to increase its actual utility common equity component to 35 percent by the end of 2007 and 38 percent by the end of 2008, which is consistent with provisions of the Company's Washington general rate case implemented on January 1, 2006. The calculation of the utility equity component is essentially the ratio of Avista Corp.'s total common equity to total capitalization excluding, in each case, Avista Corp.'s investment in Avista Capital. In addition, IPUC approval would be required for any dividend from Avista Corp. to the holding company that would reduce utility common equity below 25 percent of total capitalization which, for this purpose, includes long and short-term debt, capitalized lease obligations and preferred and common equity.

The WUTC accepted a similar stipulation entered into between Avista Corp. and the WUTC staff. The stipulation requires Avista Corp. to increase its actual utility common equity component to 40 percent by June 30, 2008. In addition, WUTC approval would be required for any dividend from Avista Corp. to the holding company that would reduce utility common equity below 30 percent of total capitalization.

Pursuant to the Plan of Share Exchange, a statutory share exchange would be effected whereby each outstanding share of Avista Corp. common stock would be exchanged for one share of AVA common stock, no par value, so that holders of Avista Corp. common stock would become holders of AVA common stock and Avista Corp. would become a subsidiary of AVA. The other outstanding securities of Avista Corp. would not be affected by the statutory share exchange, with limited exceptions for stock options and other securities outstanding under equity compensation and employee benefit plans.

**NOTE 14. INFORMATION BY BUSINESS SEGMENTS**

The business segment presentation reflects the basis currently used by the Company's management to analyze performance and determine the allocation of resources. Avista Utilities' business is managed based on the total regulated utility operation. The Energy Marketing and Resource Management business segment primarily consists of electricity and natural gas marketing, trading and resource management, including optimization of energy assets owned by other entities and derivative commodity instruments such as futures, options, swaps and other contractual arrangements. On April 16, 2007, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement to sell substantially all of their contracts and ongoing operations. Completion of this transaction will effectively end the majority of the operations of the Energy Marketing and Resource Management business segment. See Note 3 for further information. Advantage IQ is a provider of facility information and cost management services for multi-site customers throughout North America. The Other business segment includes other investments and operations of various subsidiaries as well as certain other operations of Avista Capital.

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

| | Avista Utilities | Energy Marketing And Resource Management | Advantage IQ | Other | Intersegment Eliminations (1) | Total |
|---|---|---|---|---|---|---|
| **For the three months ended March 31, 2007:** | | | | | | |
| Operating revenues | $ 414,266 | $ 29,409 | $ 10,999 | $ 4,513 | $ — | $ 459,187 |
| Resource costs | 269,986 | 37,727 | — | — | — | 307,713 |
| Gross margin | 144,280 | (8,318) | — | — | — | 135,962 |
| Other operating expenses | 49,041 | 5,085 | 7,827 | 4,224 | — | 66,177 |
| Depreciation and amortization | 21,090 | 178 | 596 | 501 | — | 22,365 |
| Income (loss) from operations | 50,154 | (13,581) | 2,576 | (212) | — | 38,937 |
| Interest expense (2) | 22,021 | 83 | 81 | 144 | (146) | 22,183 |
| Income taxes | 10,997 | (4,332) | 912 | (90) | — | 7,487 |
| Net income (loss) | 19,927 | (7,623) | 1,584 | 206 | — | 14,094 |
| Capital expenditures | 40,555 | 206 | 758 | 375 | — | 41,894 |
| **For the three months ended March 31, 2006:** | | | | | | |
| Operating revenues | $ 423,290 | $ 61,542 | $ 9,076 | $ 5,294 | $ — | $ 499,202 |
| Resource costs | 271,605 | 50,127 | — | — | — | 321,732 |
| Gross margin | 151,685 | 11,415 | — | — | — | 163,100 |
| Other operating expenses | 45,727 | 4,753 | 6,163 | 5,395 | — | 62,038 |
| Depreciation and amortization | 20,980 | 342 | 515 | 591 | — | 22,428 |
| Income (loss) from operations | 62,912 | 6,320 | 2,398 | (692) | — | 70,938 |
| Interest expense (2) | 23,680 | 46 | 196 | 568 | (641) | 23,849 |
| Income taxes | 15,811 | 2,709 | 775 | (778) | — | 18,517 |
| Net income (loss) | 26,172 | 5,046 | 1,427 | (1,073) | — | 31,572 |
| Capital expenditures | 29,743 | 271 | 365 | 1 | — | 30,380 |
| **Total Assets:** | | | | | | |
| Total assets as of March 31, 2007 | $2,821,337 | $ 936,987 | $102,259 | $44,046 | $ — | $3,904,629 |
| Total assets as of December 31, 2006 | 2,895,883 | 1,017,203 | 100,431 | 42,991 | — | 4,056,508 |

(1) Intersegment eliminations reported as interest expense represent intercompany interest.
(2) Including interest expense to affiliated trusts.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of
Avista Corporation
Spokane, Washington

We have reviewed the accompanying consolidated balance sheet of Avista Corporation and subsidiaries (the "Corporation") as of March 31, 2007, and the related consolidated statements of income, comprehensive income, and cash flows for the three-month periods ended March 31, 2007 and 2006. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Avista Corporation and subsidiaries as of December 31, 2006, and the related consolidated statements of income, comprehensive income, and cash flows for the year then ended (not presented herein); and in our report dated February 26, 2007, we expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph for certain changes in accounting and presentation resulting from the impact of recently adopted accounting standards. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Deloitte & Touche LLP

May 3, 2007

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Forward-Looking Statements**

From time to time, we make forward-looking statements such as statements regarding projected or future:

- financial performance,
- capital expenditures,
- dividends,
- capital structure,
- other financial items,
- strategic goals and objectives, and
- plans for operations.

These statements have underlying assumptions (many of which are based, in turn, upon further assumptions). Such statements are made both in our reports filed under the Securities Exchange Act of 1934, as amended (including this Quarterly Report on Form 10-Q), and elsewhere. Forward-looking statements are all statements except those of historical fact including, without limitation, those that are identified by the use of words that include "will," "may," "could," "should," "intends," "plans," "seeks," "anticipates," "estimates," "expects," "forecasts," "projects," "predicts," and similar expressions.

All forward-looking statements (including those made in this Quarterly Report on Form 10-Q) are subject to a variety of risks and uncertainties and other factors. Most of these factors are beyond our control and many of them could have a significant effect on our operations, results of operations, financial condition or cash flows. This could cause actual results to differ materially from those anticipated in our statements. Such risks, uncertainties and other factors include, among others:

- the completion of the sale of Avista Energy's contracts and ongoing operations as contemplated;
- weather conditions, including the effect of precipitation and temperatures on the availability of hydroelectric resources and the effect of temperatures on customer demand;
- changes in wholesale energy prices that can affect, among other things, cash needed to purchase electricity, natural gas for our retail customers and natural gas fuel for electric generation, and the value of surplus energy sold, as well as the market value of derivative assets and liabilities and unrealized gains and losses;
- volatility and illiquidity in wholesale energy markets, including the availability and prices of purchased energy and demand for energy sales;
- the effect of state and federal regulatory decisions affecting our ability to recover costs and/or earn a reasonable return including, but not limited to, the disallowance of costs that we have deferred;
- the outcome of pending regulatory and legal proceedings arising out of the "western energy crisis" of 2000 and 2001, and including possible retroactive price caps and resulting refunds;
- the outcome of legal proceedings and other contingencies concerning us or affecting directly or indirectly our operations;
- the potential effects of any legislation or administrative rulemaking passed into law, including the possible adoption of national, regional, or state restrictions on greenhouse gas emissions and global warming;
- changes in, and compliance with, environmental and endangered species laws, regulations, decisions and policies, including present and potential environmental remediation costs;
- the potential impact of changes to electric transmission ownership, operation and governance, such as the formation of one or more regional transmission organizations or similar entities;
- wholesale and retail competition including, but not limited to, electric retail wheeling and transmission costs;
- the ability to relicense and maintain licenses for our hydroelectric generating facilities at cost-effective levels with reasonable terms and conditions;
- unplanned outages at any of our generating facilities or the inability of facilities to operate as intended;
- unanticipated delays or changes in construction costs, as well as our ability to obtain required operating permits for present or prospective facilities;
- natural disasters that can disrupt energy production or delivery, as well as the availability and costs of materials and supplies and support services;
- blackouts or disruptions of interconnected transmission systems;
- the potential for future terrorist attacks or other malicious acts, particularly with respect to our utility assets;
- changes in the long-term climate of the Pacific Northwest, which can affect, among other things, customer demand patterns and the volume and timing of streamflows to our hydroelectric resources;
- changes in future economic conditions in our service territory and the United States in general, including inflation or deflation and monetary policy;

- changes in industrial, commercial and residential growth and demographic patterns in our service territory;
- the loss of significant customers and/or suppliers;
- failure to deliver on the part of any parties from which we purchase and/or sell capacity or energy;
- changes in the creditworthiness of our customers and energy trading counterparties;
- our ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including our credit ratings, interest rates and other capital market conditions;
- the effect of any change in our credit ratings;
- changes in actuarial assumptions, the interest rate environment and the actual return on plan assets for our pension plan, which can affect future funding obligations, costs and pension plan liabilities;
- increasing health care costs and the resulting effect on health insurance premiums paid for our employees and retirees;
- increasing costs of insurance, changes in coverage terms and our ability to obtain insurance;
- employee issues, including changes in collective bargaining unit agreements, strikes, work stoppages or the loss of key executives, as well as our ability to recruit and retain employees;
- the potential effects of negative publicity regarding business practices, whether true or not, which could result in, among other things, costly litigation and a decline in our common stock price;
- changes in technologies, possibly making some of the current technology quickly obsolete;
- changes in tax rates and/or policies; and
- changes in our strategic business plans and/or our subsidiaries, which may be affected by any or all of the foregoing, including the entry into new businesses and/or the exit from existing businesses.

Our expectations, beliefs and projections are expressed in good faith. We believe they have a reasonable basis including, without limitation, an examination of historical operating trends, data contained in our records and other data available from third parties. However, there can be no assurance that our expectations, beliefs or projections will be achieved or accomplished. Furthermore, any forward-looking statement speaks only as of the date on which such statement is made. We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances that occur after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of such factors, nor can we assess the effect of each such factor on our business or the extent to which any such factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

The following discussion and analysis is provided for the consolidated financial condition and results of operations of Avista Corp. and its subsidiaries. This discussion focuses on significant factors concerning our financial condition and results of operations and should be read along with the consolidated financial statements.

**Potential Holding Company Formation**

In May 2006, our shareholders approved a proposal to proceed with a statutory share exchange, which would change our organization to a holding company structure. If the implementation of the holding company structure is approved by regulators on terms acceptable to us, it may be completed sometime after mid-2007. See further information at “Note 13 of the Notes to Consolidated Financial Statements.”

**Business Segments**

We have four business segments as follows:

- **Avista Utilities** – generation, transmission and distribution of electric energy and distribution of natural gas to retail customers, as well as wholesale purchases and sales of energy commodities. Avista Utilities is an operating division of Avista Corp. comprising our regulated utility operations.
- **Energy Marketing and Resource Management** – electricity and natural gas marketing, trading and resource management. The activities of this business segment are conducted primarily by Avista Energy, Inc., an indirect subsidiary of Avista Corp. In April 2007, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement to sell substantially all of their contracts and ongoing operations. Completion of this transaction will effectively end the majority of the operations of this business segment.
- **Advantage IQ** – facility information and cost management services for multi-site customers. The activities of this business segment are conducted by Advantage IQ, Inc., an indirect subsidiary of Avista Corp.
- **Other** – includes sheet metal fabrication, venture fund investments and real estate investments. The activities of this business segment are conducted by various indirect subsidiaries of Avista Corp., including Advanced Manufacturing and Development (AM&D), doing business as METALfx.

Avista Energy, Advantage IQ and the various companies in the Other business segment are subsidiaries of Avista Capital, which is a direct, wholly owned subsidiary of Avista Corp. Our total common stockholders' equity was $927.3 million as of March 31, 2007, of which $242.9 million represented our investment in Avista Capital.

The following table presents net income (loss) for each of our business segments for the three months ended March 31 (dollars in thousands):

| | 2007 | 2006 |
|---|---|---|
| Avista Utilities | $19,927 | $26,172 |
| Energy Marketing and Resource Management | (7,623) | 5,046 |
| Advantage IQ | 1,584 | 1,427 |
| Other | 206 | (1,073) |
| Net income | $14,094 | $31,572 |

**Executive Level Summary**

***Overall***

Our operating results and cash flows are derived primarily from:

- regulated utility operations (Avista Utilities),
- energy trading, marketing and resource management activities (Avista Energy in the Energy Marketing and Resource Management segment), and
- Advantage IQ.

We intend to continue to focus on improving earnings and operating cash flows, controlling costs and reducing debt while working to restore an investment grade credit rating.

On April 16, 2007, Avista Energy and Avista Energy Canada entered into a purchase and sale agreement to sell substantially all of their contracts and ongoing operations to Coral Energy Holding, L.P. (Coral Energy), as well as certain other subsidiaries of Coral Energy. After closing costs and other adjustments, we do not expect the transaction to result in a significant gain or loss. Proceeds from the transaction will include cash consideration for the net assets acquired by Coral Energy and liquidation of the net current assets of Avista Energy not sold to Coral Energy (primarily receivables, restricted cash and deposits with counterparties). Over time, we plan to redeploy the majority of the estimated $175 million of proceeds from the transaction into our regulated utility operations by reducing debt and investing in capital assets. Until the transaction is completed, Avista Energy's results of operations will continue to be reflected in our consolidated financial statements.

Our net income was $14.1 million for the three months ended March 31, 2007 compared to $31.6 million for the three months ended March 31, 2006. This decrease was primarily due to a net loss in the Energy Marketing and Resource Management segment (Avista Energy) and lower earnings at Avista Utilities.

***Avista Utilities***

Avista Utilities is our most significant business segment. Our utility operating and financial performance is dependent upon, among other things:

- weather conditions,
- the price of natural gas in the wholesale market, including the effect on the price of fuel for generation,
- the price of electricity in the wholesale market, including the effects of weather conditions, natural gas prices and other factors affecting supply and demand, and
- regulatory decisions, allowing our utility to recover costs, including purchased power and fuel costs, on a timely basis, and to earn a fair return on investment.

Weather has a significant effect on our utility operations. Weather can impact customer demand and operating revenues and we normally have our highest retail (electric and natural gas) energy sales during the winter heating season in the first and fourth quarters of the year. We also have high electricity demand for air conditioning during the summer (third quarter). In general, warmer weather in the heating season and cooler weather in the cooling season will reduce operating revenues. In addition, a reduction in precipitation (particularly winter snowpack) can negatively impact electric resource costs by decreasing hydroelectric generation capability and increasing the costs for fuel to run thermal generation. This also increases the need for cash to purchase electric resources in the wholesale market. Regional precipitation and snowpack conditions typically have a significant effect on the wholesale price of electricity. In addition, high demand for electricity will generally increase the cost of fuel for electric generation and wholesale electric market prices.

Our hydroelectric generation was 104 percent of normal in 2006. For 2007, we are forecasting hydroelectric generation to be normal. This 2007 forecast will be revised based on precipitation, temperatures and other variables during the year.

We are subject to electric and natural gas commodity price risk. In general, price risk is the risk of fluctuation in the market price of the commodity needed, held or traded. Changes in energy commodity prices have a significant effect on our liquidity, as well as the market value of derivative assets and liabilities and unrealized gains and losses. Our utility operation has regulatory mechanisms in place that provide for the deferral and recovery of the majority of power and natural gas supply costs. However, if prices increase above the level currently recovered in retail rates during periods when we must purchase energy, power and natural gas deferral balances will increase. This would negatively affect operating cash flows and liquidity until such costs, with interest, are recovered from customers.

Our utility net income was $19.9 million for the three months ended March 31, 2007, a decrease from $26.2 million for the three months ended March 31, 2006 primarily due to a decrease in gross margin (operating revenues less resource costs). The decrease was also due to an increase in other operating expenses and taxes other than income taxes, partially offset by a decrease in interest expense. The decrease in gross margin was primarily due to an increase in electric resource costs as compared to the amount included in base retail rates. We recognized an expense of $3.2 million under the Washington Energy Recovery Mechanism (ERM) for the three months ended March 31, 2007 compared to a benefit of $5.2 million under the ERM for the three months ended March 31, 2006.

We plan to continue to invest in generation, transmission and distribution systems with a focus on providing reliable service to our customers. Utility capital expenditures were $40.6 million for the three months ended March 31, 2007. We are expecting utility capital expenditures to be $180 million for 2007. Significant projects include the continued enhancement of our transmission system and upgrades to our generation facilities.

We are not expecting to receive any general rate increases in 2007 and we expect to absorb expenses under the ERM in 2007 as compared to a benefit in 2006. Based primarily on these factors, utility net income may decrease for 2007 as compared to 2006. We filed a general rate case in Washington in April 2007 requesting rate increases averaging 15.9 percent for electric and 2.3 percent for natural gas. Any rate adjustments, if approved by the WUTC, would most likely become effective in 2008.

***Energy Marketing and Resource Management (Avista Energy)***

Given the significant changes in the energy marketplace over the past few years, we explored whether we should continue in this business over the long term or if any strategic alternatives were available that would allow Avista Energy to grow and reach its earnings potential. As such, we reached a decision to sell the majority of this business.

The activities of Avista Energy include:

- trading electricity and natural gas,
- the 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 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.

Our earnings and cash flows from this business segment are by nature subject to significant variability because they are derived primarily from the day-to-day trading of electricity and natural gas and optimization of assets owned by other entities, rather than predictable long-term revenue streams. Also, these activities are for the most part subject to mark-to-market accounting. However, this is different from the required accounting for natural gas storage and certain other assets and contracts. As such, our earnings from Avista Energy are subject to variability caused by the differences between the estimated market value and the required accounting for these assets and contracts.

Primarily through Avista Energy, we are involved in a number of legal and regulatory proceedings and complaints with respect to power markets in the western United States that remain unresolved. However, we believe that we have adequate reserves established for refunds that may be ordered. Any potential refunds or obligations arising from western power market issues (or any other contingent matters) will not be assumed by Coral Energy.

The Energy Marketing and Resource Management segment had a net loss of $7.6 million for the three months ended March 31, 2007 compared to net income of $5.0 million for the three months ended March 31, 2006. These lower results from Avista Energy were primarily due to underperformance on the power side of the business and losses on a power purchase agreement related to a natural gas-fired combined cycle combustion turbine plant in northern Idaho

(Lancaster Plant). The difference between the estimated market value and the required accounting for certain contracts and physical assets under management increased the net loss by $3.5 million from this segment for the three months ended March 31, 2007 and increased net income by $2.6 million for the three months ended March 31, 2006.

***Advantage IQ***

Our subsidiary, Advantage IQ, had net income of $1.6 million for the three months ended March 31, 2007, an increase from $1.4 million for the three months ended March 31, 2006, primarily due to increased operating revenues. This was a result of customer growth and an increase in interest earnings on funds held for customers.

We are implementing certain strategic investments at Advantage IQ aimed at creating long-term savings that will increase operating and capitalized costs in the short term through up-front expenditures. This could limit earnings growth from this segment in 2007 while enhancing the long-term profit potential of Advantage IQ.

***Other Business Segment***

Over time as opportunities arise, we plan to dispose of assets and phase out operations in the Other business segment. However, we may invest incremental funds in these businesses to protect existing investments. Net income in our Other business segment was $0.2 million for the three months ended March 31, 2007, compared to a net loss of $1.1 million for the three months ended March 31, 2006. This improvement in results was primarily due to net gains on certain long-term venture fund investments in 2007 as compared to net losses in 2006. We are not expecting a significant change in results from this business segment for 2007 as compared to 2006.

***Liquidity and Capital Resources***

We have a committed line of credit in the total amount of $320.0 million with an expiration date of April 2011. No borrowings were outstanding under the committed line of credit at March 31, 2007.

In March 2007, we amended our accounts receivable sales facility to extend the termination date to March 2008. Under this facility, we can sell without recourse, on a revolving basis, up to $85.0 million of accounts receivable.

Avista Energy has a $145.0 million committed line of credit that expires in July 2007 and expects to extend this credit agreement if necessary and terminate the facility with the closing of the sale of contracts and ongoing operations to Coral Energy.

In December 2006, we entered into a sales agency agreement with a sales agent to issue up to 2 million shares of our common stock from time to time. Due to the expected proceeds from the sale and liquidation of Avista Energy’s assets, we are not currently planning to issue any shares under this agreement.

For 2007, we expect net cash flows from operating activities, proceeds from the sale and liquidation of Avista Energy’s assets and our $320.0 million committed line of credit to provide adequate resources to fund:

- capital expenditures,
- maturing long-term debt and preferred stock,
- dividends, and
- other contractual commitments.

***Succession Planning***

We have management succession plans that work towards ensuring that executive officer and key management positions can be appropriately filled as vacancies occur. We also have workforce development plans for key technical and craft areas.

On February 9, 2007, Gary G. Ely, Chairman of the Board and Chief Executive Officer of Avista Corp., announced to the Company’s board of directors that he will retire from the Company and the board, effective December 31, 2007. Following Mr. Ely’s announcement, the Company’s board of directors appointed Scott L. Morris, President and Chief Operating Officer of Avista Corp., to serve as a director on the board. The Company’s board of directors also elected Mr. Morris to the positions of Chairman of the Board and Chief Executive Officer of Avista Corp., effective January 1, 2008.

On April 23, 2007, the Company announced that Ronald R. Peterson, Vice President of Avista Corp. and Vice President of Energy Resources and Optimization of Avista Utilities will retire from the Company on August 1, 2007. Dennis Vermillion, President and Chief Operating Officer of Avista Energy, has been named Vice President of Energy Resources and Optimization of Avista Utilities effective upon the closing of the sale of the contracts and ongoing operations of Avista Energy to Coral Energy. This is expected to occur late in the second quarter or early in the third quarter of 2007.

**Avista Utilities – Regulatory Matters**

***General Rate Cases***

In recent years, we have generally not earned our authorized rates of return in our regulated utility operations. We regularly review the need for electric and natural gas rate changes in each state in which we provide service. We will continue to file for rate adjustments to:

- provide for recovery of operating costs and capital investments, and
- more closely align earned returns with those allowed by regulators.

With regards to the timing and plans for future filings, the assessment of our need for rate relief and the development of rate case plans takes into consideration short-term and long-term needs, as well as specific factors that can affect the timing of rate filings. Such factors include in-service dates of major infrastructure investments and the timing of changes in major revenue and expense items.

We filed a general rate case in Washington in April 2007. In the general rate case, we have requested to increase electric rates for our Washington customers by an average of 15.9 percent, which is intended to increase annual revenues by $51.1 million. We have also requested to increase natural gas rates by an average of 2.3 percent, which is intended to increase annual revenues by $4.5 million. Our request is based on a proposed rate of return of 9.39 percent with a common equity ratio of 47.8 percent and an 11.3 percent return on equity. The WUTC generally has up to 11 months to review the general rate case filing.

The following is a summary of our authorized rates of return in each jurisdiction:

| Jurisdiction and service | Implementation Date | Authorized Overall Rate of Return | Authorized Return on Equity | Authorized Equity Level |
|---|---|---|---|---|
| Washington electric and natural gas | January 2006 | 9.11% | 10.40% | 40% |
| Idaho electric and natural gas | September 2004 | 9.25% | 10.40% | 43% |
| Oregon natural gas | October 2003 | 8.88% | 10.25% | 48% |

As part of the general rate case settlement agreement that was modified and approved by the WUTC Order in December 2005, we agreed to increase the utility equity component to 35 percent by the end of 2007 and 38 percent by the end of 2008. If we do not meet those targets, it could result in a reduction to base rates of 2 percent for each target. The calculation of the utility equity component is essentially the ratio of our total consolidated common equity to total capitalization excluding, in each case, our investment in Avista Capital. The utility equity component was 39.5 percent as of March 31, 2007. We should be able to meet these equity targets through expected earnings and proceeds from the Avista Energy transaction.

***Oregon Senate Bill 408***

The Public Utility Commission of Oregon (OPUC) issued final rules related to Oregon Senate Bill 408 (OSB 408). OSB 408 was enacted into law in 2005. These rules direct the utility to establish an automatic adjustment clause to account for the difference between income taxes collected in rates and taxes paid to units of government, net of adjustments, when that difference exceeds $100,000. The automatic adjustment clause may result in either rate increases or rate decreases and applies only to taxes paid and collected on or after January 1, 2006.

The final rules provide for an “apportionment method” that uses a three-factor formula consisting of property, payroll and sales for regulated operations of the utility in Oregon as the numerator, and these same factors for the consolidated company as the denominator, to determine the amount of consolidated taxes paid that are properly attributed to Oregon operations. Under the new rules, we will determine the least of:

- the properly attributed amount of taxes paid using the apportionment method,
- the amount of taxes determined on a stand-alone basis for Oregon operations, and
- total consolidated taxes paid.

We will then compare this amount to taxes collected in rates to determine if a refund or surcharge is required.

As required by OPUC orders, we (along with other utilities in Oregon) filed a private letter ruling request with the Internal Revenue Service in December 2006. The private letter ruling request seeks guidance on whether OSB 408 and the related OPUC orders violate normalization rules for accounting for income taxes. Certain parties (including Avista Corp.) are seeking legislative changes related to OSB 408. Based on an analysis of operating results for prior years and current rules, we recorded a liability for potential refunds to our customers of $1.3 million for 2006 and $0.3 million for the first quarter of 2007.

***Natural Gas Decoupling***

In February 2007, the WUTC approved the implementation of a natural gas decoupling mechanism. Decoupling separates the direct link between natural gas sales volume and the recovery of the fixed cost of providing service to our customers. Because our rate structure provides for recovery of the majority of fixed costs on a per-therm (sales volume) basis, energy efficiency and conservation objectives have been directly at odds with the recovery of fixed costs, which do not vary with the volume of natural gas sold. Our decoupling mechanism should allow us to recover lost margin resulting from lower usage by Washington customers due to conservation and price elasticity. However, it will not provide rate adjustments related to abnormal weather. The decoupling mechanism is a three-year "pilot" that began in January 2007. A rate adjustment in any one year would be limited to no more than 2 percent. The filing of the first decoupling rate adjustment will be in the fall of 2007.

***Accounting Order for Debt Repurchase Costs***

The WUTC staff raised questions and requested information regarding our method of amortization of costs related to debt repurchased between 2002 and 2006. After discussions with the WUTC staff, we agree that the costs associated with debt repurchases beginning in 2002 should have been accounted for in accordance with FERC General Instruction 17 (FERC 17). In February 2007, we filed a request with the WUTC for an accounting order approving our current accounting treatment for debt repurchase costs. In April 2007, the WUTC indicated that this issue will be addressed in a general rate case filing and we have included this request within our general rate case filing. In the April general rate case filing, we agreed that costs associated with any new repurchases of debt would be accounted for in accordance with FERC General Instruction 17 (FERC 17), and in the event we desire to account for the cost of new debt repurchases differently than prescribed in FERC 17, we would request an accounting order from the WUTC prior to the repurchase. Under FERC 17, debt repurchase costs are amortized over the remaining life of the original debt that was repurchased or, if new debt is issued in connection with the repurchase, these costs can be amortized over the life of the new debt. We have amortized debt repurchase costs over the average remaining maturity of outstanding debt and these costs are currently recovered through retail rates as a component of interest expense. In our request for an accounting order, we are not proposing to change the amortization method for debt repurchase costs incurred prior to December 31, 2006.

***Power Cost Deferrals and Recovery Mechanisms***

The ERM is an accounting method used to track certain differences between actual power supply costs and the amount included in base retail rates for our Washington customers. This difference in power supply costs primarily results from changes in:

- short-term wholesale market prices,
- the level of hydroelectric generation, and
- the level of thermal generation (including changes in fuel prices).

The initial amount of power supply costs in excess or below the level in retail rates, which we either incur the cost of, or receive the benefit from, is referred to as the deadband. The annual deadband amount is currently $4.0 million. We will incur the cost of, or receive the benefit from, 100 percent of this initial power supply cost variance. We will share annual power supply cost variances between $4.0 million and $10.0 million with customers. As such, 50 percent of the annual power supply cost variance in this range is deferred for future surcharge or rebate to customers and we will incur the cost of, or receive the benefit from, the remaining 50 percent. Once the annual power supply cost variance from the amount included in base rates exceeds $10.0 million, 90 percent of the cost variance is deferred for future surcharge or rebate. We will incur the cost of, or receive the benefit from, the remaining 10 percent of the annual variance beyond $10.0 million without affecting current or future customer rates. The following is a summary of the ERM:

| Annual Power Supply Cost Variability | Deferred for Future Surcharge or Rebate to Customers | Expense or Benefit to the Company |
|---|---|---|
| +/- $0—$4 million | 0% | 100% |
| +/- between $4 million—$10 million | 50% | 50% |
| +/- excess over $10 million | 90% | 10% |

Under the ERM, we make an annual filing on or before April 1st of each year to provide the opportunity for the WUTC and other interested parties to review the prudence of and audit the ERM deferred power cost transactions for the prior calendar year. The ERM provides for a 90-day review period for the filing; however, the period may be extended by agreement of the parties or by WUTC order.

We have a PCA mechanism in Idaho that allows us to modify electric rates periodically with IPUC approval. Under the PCA mechanism, we defer 90 percent of the difference between certain actual net power supply expenses and the amount included in base retail rates for our Idaho customers. The PCA rate surcharge is currently 2.5 percent.

The following table shows activity in deferred power costs for Washington and Idaho during the three months ended March 31, 2007 (dollars in thousands):

| | Washington | Idaho | Total |
|---|---|---|---|
| Deferred power costs as of December 31, 2006 | $ 70,159 | $ 9,357 | $ 79,516 |
| Activity from January 1 – March 31, 2007: | | | |
| Power costs deferred | — | 3,797 | 3,797 |
| Interest and other net additions | 831 | 182 | 1,013 |
| Recovery of deferred power costs through retail rates | (9,140) | (1,319) | (10,459) |
| Deferred power costs as of March 31, 2007 | $ 61,850 | $12,017 | $ 73,867 |

***Purchased Gas Adjustments***

Effective November 1, 2006, natural gas rates:

- increased 1.3 percent in Washington,
- decreased 3.4 percent in Idaho, and
- increased 6.9 percent in Oregon.

These natural gas rate increases and decreases are designed to pass through changes in purchased natural gas costs to our customers with no change in gross margin or net income. The increase in Oregon was approved subject to refund pending further review of our natural gas purchasing and hedging strategies. We have entered into a settlement agreement with the OPUC staff and the Northwest Industrial Gas Users related to this review, which is subject to approval by the OPUC. Total deferred natural gas costs were $10.2 million as of March 31, 2007, a decrease from $18.3 million as of December 31, 2006 primarily due to recovery from customers during the first quarter of 2007.

**Legal and Regulatory Proceedings in Western Power Markets**

We are involved in a number of legal and regulatory proceedings and complaints with respect to power markets in the western United States. Most of these proceedings and complaints relate to the significant increase in the spot market price of energy in western power markets in 2000 and 2001, which allegedly contributed to or caused unjust and unreasonable prices. These proceedings and complaints include, but are not limited to:

- refund proceedings in California and the Pacific Northwest,
- market conduct investigations by the FERC, and
- complaints filed by various parties related to alleged misconduct by other parties in western power markets.

As a result of these proceedings and complaints, certain parties have asserted claims for refunds and damages from us (primarily through Avista Energy), which could result in a negative effect on future earnings. However, we believe that we have adequate reserves established for refunds that may be ordered. We have joined other parties in opposing these refund claims and complaints for damages. See further information in “Note 12 of the Notes to Consolidated Financial Statements.” Any potential refunds or obligations of Avista Energy arising from western power market issues (or any other contingent matters) will not be assumed by Coral Energy.

**Results of Operations**

The following provides an overview of changes in our Consolidated Statements of Income. More detailed explanations are provided, particularly for operating revenues and operating expenses in the business segment discussions (Avista Utilities, Energy Marketing and Resource Management, Advantage IQ and Other) that follow this section.

Utility revenues decreased $9.0 million to $414.3 million due to a decrease in electric revenues of $31.8 million reflecting decreased wholesale revenues and sales of fuel, partially offset by increased retail revenues. This was partially offset by increased natural gas revenues of $22.8 million due to increased wholesale (primarily due to increased volumes) and retail (due to an increase in rates and volumes) natural gas sales.

Non-utility energy marketing and trading revenues decreased $32.1 million to $29.4 million primarily due to a decrease of $24.9 million in net trading margin on contracts accounted for under SFAS No. 133, as amended, and a $7.2 million decrease from sales of natural gas to commercial and industrial end-user customers (both through Avista Energy Canada and to Montana customers).

Other non-utility revenues increased $1.1 million to $15.5 million as a result of increased revenues from Advantage IQ of $1.9 million primarily due to customer growth as well as an increase in interest earnings on funds held for customers. This was partially offset by decreased revenues from the Other business segment of $0.8 million primarily due to decreased sales at AM&D.

Utility resource costs decreased $1.6 million primarily due to a decrease in electric resource costs of $22.3 million reflecting a decrease in other fuel costs (economic sales of fuel that was not used in generation) and purchased power costs. These decreases are consistent with reduced resource optimization activities and lower sales of fuel and wholesale sales as part of the process of balancing loads and resources. The decrease in electric resource costs was partially offset by an increase in natural gas resource costs of $20.7 million primarily reflecting an increase in the volume of purchases.

Utility other operating expenses increased $3.3 million primarily due to increased employee compensation expense and outside services.

Utility taxes other than income taxes increased $1.9 million primarily due to increased retail electric and natural gas revenues and related taxes.

Non-utility resource costs decreased $12.4 million primarily due to decreased resource costs related to sales of natural gas to commercial and industrial end-user customers, and decreased transportation and transmission costs.

The net change in other non-utility operating expenses was an increase of $0.8 million due to:

- an increase of $0.3 million in the Energy Marketing and Resource Management segment due to necessary adjustments to reduce the carrying value of net assets to be sold to their estimated fair value less costs to sell, offset by decreased incentive compensation based on lower earnings,
- an increase of $1.7 million for Advantage IQ due to expanding operations, and
- a decrease of $1.2 million in the Other business segment due to lower operating expense at AM&D and the accrual of an environmental liability at Avista Development during the first quarter of 2006.

Interest expense decreased $1.8 million primarily due to our issuance of fixed rate long-term debt that replaced maturing debt (which had relatively high interest rates) in the fourth quarter of 2006, as well as a decrease in the amount of short-term borrowings outstanding.

Capitalized interest increased $0.6 million due to increased utility construction activity and the associated increase in construction work in progress balances.

Other income-net increased $1.2 million due to an increase in interest income and gains on long-term venture fund investments (Other segment), partially offset by a decrease in interest on power and natural gas deferrals.

Income taxes decreased $11.0 million primarily due to decreased income before income taxes. Our effective tax rate was 34.7 percent for the three months ended March 31, 2007 compared to 37.0 percent for the three months ended March 31, 2006.

**Avista Utilities**

Net income for the utility was $19.9 million for the three months ended March 31, 2007 compared to $26.2 million for the three months ended March 31, 2006. Utility income from operations was $50.2 million for the three months ended March 31, 2007 compared to $62.9 million for the three months ended March 31, 2006. This decrease in income from operations was primarily due to decreased gross margin (operating revenues less resource costs). The decrease was also due to:

- an increase in utility taxes other than income taxes (primarily due to increased retail electric and natural gas revenues and related taxes), and
- an increase in other utility operating expenses (primarily employee compensation and outside services).

The following table presents our utility gross margin for the three months ended March 31 (dollars in thousands):

| | Electric | | Natural Gas | | Total | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Operating revenues | $ 190,168 | $ 222,008 | $ 224,098 | $ 201,282 | $ 414,266 | $ 423,290 |
| Resource costs | 92,064 | 114,404 | 177,922 | 157,201 | 269,986 | 271,605 |
| Gross margin | $ 98,104 | $ 107,604 | $ 46,176 | $ 44,081 | $ 144,280 | $ 151,685 |

Utility operating revenues decreased $9.0 million and utility resource costs decreased $1.6 million, which resulted in a decrease of $7.4 million in gross margin. The gross margin on electric sales decreased $9.5 million and the gross margin on natural gas sales increased $2.1 million. The decrease in our electric gross margin was primarily due to an

increase in electric resource costs as compared to the amount included in base retail rates resulting in the expense of $3.2 million (of the $4.0 million deadband) of power supply costs in Washington above the amount included in base retail rates during the first quarter of 2007. In the first quarter of 2006, we received a benefit of $5.2 million under the ERM. The increase in power supply costs for 2007 (as compared to the amount included in base rates) was primarily a result of higher fuel costs and greater use of our thermal generating resources (particularly Coyote Springs 2) to meet higher demand in January and February. The increase in natural gas gross margin was primarily due to colder weather in 2007 and customer growth.

The following table presents our utility electric operating revenues and megawatt-hour (MWh) sales for the three months ended March 31 (dollars and MWhs in thousands):

| | Electric Operating Revenues | | Electric Energy MWh sales | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Residential | $ 73,096 | $ 68,747 | 1,107 | 1,042 |
| Commercial | 55,111 | 52,594 | 771 | 735 |
| Industrial | 22,247 | 22,774 | 493 | 509 |
| Public street and highway lighting | 1,406 | 1,279 | 6 | 6 |
| Total retail | 151,860 | 145,394 | 2,377 | 2,292 |
| Wholesale | 26,308 | 39,152 | 342 | 474 |
| Sales of fuel | 8,143 | 30,937 | — | — |
| Other | 3,857 | 6,525 | — | — |
| Total | $ 190,168 | $ 222,008 | 2,719 | 2,766 |

Retail electric revenues increased $6.5 million due to an increase in:

- total MWhs sold (increased revenues $5.4 million) primarily due to customer growth and partially due to an increase in use per customer, and
- revenue per MWh (increased revenues $1.1 million) due to a slight change in revenue mix with a lower percentage of industrial sales.

The increase in use per customer was primarily due to colder weather.

Wholesale electric revenues decreased $12.8 million due to a decrease in sales:

- volumes (decreased revenues $10.2 million) consistent with decreased wholesale purchases and decreased resource optimization activities, and
- prices (decreased revenues $2.6 million).

When electric wholesale market prices are below the cost of operating our natural gas-fired thermal generating units, we sell the natural gas purchased for generation in the wholesale market as sales of fuel. Sales of fuel decreased $22.8 million as a greater percentage of our fuel purchases were used in generation.

Other electric revenues decreased $2.7 million primarily as a result of revenues of $3.0 million from the sale of claims we had against Enron Corporation and certain of its affiliates received in the first quarter of 2006, partially offset by increased transmission revenues.

The following table presents our utility natural gas operating revenues and therms delivered for the three months ended March 31 (dollars and therms in thousands):

| | Natural Gas Operating Revenues | | Natural Gas Therms Delivered | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Residential | $ 112,539 | $ 105,133 | 83,863 | 81,062 |
| Commercial | 61,378 | 58,093 | 49,923 | 48,723 |
| Interruptible | 1,588 | 1,708 | 1,561 | 1,673 |
| Industrial | 2,068 | 2,027 | 1,881 | 1,876 |
| Total retail | 177,573 | 166,961 | 137,228 | 133,334 |
| Wholesale | 43,534 | 31,215 | 65,463 | 45,894 |
| Transportation | 1,675 | 1,608 | 43,805 | 42,183 |
| Other | 1,316 | 1,498 | 238 | 212 |
| Total | $ 224,098 | $ 201,282 | 246,734 | 221,623 |

Natural gas revenues increased $22.8 million due to an increase in retail and wholesale natural gas revenues. The $10.6 million increase in retail natural gas revenues was due to higher retail rates (increased revenues $5.6 million)

and increased volumes (increased revenues $5.0 million). We sold more retail natural gas in the first quarter of 2007 primarily due to an increase in use per customer (due to colder weather) and customer growth. The increase in our wholesale revenues of $12.3 million was due to an increase in volumes (increased revenues $13.0 million), partially offset by a decrease in prices (decreased revenues $0.7 million). Wholesale sales reflect the balancing of loads and resources and the sale of resources in excess of load requirements as part of the natural gas procurement process.

The following table presents our average number of electric and natural gas retail customers for the three months ended March 31:

| | Electric Customers | | Natural Gas Customers | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Residential | 305,728 | 299,491 | 273,109 | 266,450 |
| Commercial | 38,334 | 37,797 | 32,245 | 31,724 |
| Interruptible | — | — | 41 | 40 |
| Industrial | 1,368 | 1,394 | 259 | 260 |
| Public street and highway lighting | 424 | 430 | — | — |
| Total retail customers | 345,854 | 339,112 | 305,654 | 298,474 |

The following table presents our utility resource costs for the three months ended March 31 (dollars in thousands):

| | 2007 | 2006 |
|---|---|---|
| Electric resource costs: | | |
| Power purchased | $ 39,879 | $ 43,918 |
| Power cost amortizations, net of deferrals | 6,662 | 10,179 |
| Fuel for generation | 34,131 | 25,327 |
| Other fuel costs | 10,896 | 34,457 |
| Other regulatory amortizations, net | (2,354) | (2,033) |
| Other electric resource costs | 2,850 | 2,556 |
| Total electric resource costs | 92,064 | 114,404 |
| Natural gas resource costs: | | |
| Natural gas purchased | 166,340 | 146,743 |
| Natural gas amortizations, net of deferrals | 8,490 | 9,463 |
| Other regulatory amortizations, net | 3,092 | 995 |
| Total natural gas resource costs | 177,922 | 157,201 |
| Total resource costs | $269,986 | $271,605 |

Power purchased decreased $4.0 million due to a decrease in the volume of power purchases (decreased costs $9.6 million) primarily due to increased thermal generation as well as decreased resource optimization activities as part of the process of balancing loads and resources. This was consistent with a decrease in wholesale sales. This was partially offset by an increase in the price of power purchases (increased costs $5.6 million) due to overall increases in wholesale markets.

Net amortization of deferred power costs was $6.7 million for the three months ended March 31, 2007 compared to $10.2 million for the three months ended March 31, 2006. During the first quarter of 2007, we recovered (collected as revenue) $9.1 million of previously deferred power costs in Washington and $1.3 million in Idaho. During the first quarter of 2007, we deferred $3.8 million of power costs in Idaho above the amount included in base retail rates. We did not defer any power costs in Washington during the first quarter of 2007, as power supply costs were within the $4.0 million deadband under the ERM.

Fuel for generation increased $8.8 million due to higher natural gas fuel prices and an increase in thermal generation volumes (particularly Coyote Springs 2).

Other fuel costs decreased $23.6 million. This represents fuel that was purchased for generation, but was later sold when conditions indicated that it was not economic to use the fuel in generation as part of the resource optimization process. The associated revenues are reflected as sales of fuel. Other fuel costs exceeded revenues we received from selling the natural gas. We account for this shortfall under the ERM in Washington and the PCA in Idaho. The decrease in other fuel costs was primarily due to an increased percentage of fuel used in generation.

The expense for natural gas purchased for sale to customers increased $19.6 million primarily due to an increase in total therms purchased. This was primarily due to an increase in wholesale sales as part of the balancing of loads and resources as part of the natural gas procurement process, and partially due to a slight increase in retail sales volumes. During the first quarter of 2007, we amortized $8.5 million of deferred natural gas costs compared to $9.5 million for the first quarter of 2006.

**Energy Marketing and Resource Management**

The Energy Marketing and Resource Management segment primarily includes the results of Avista Energy. In April 2007, Avista Energy entered into a purchase and sale agreement to sell substantially all of its contracts and ongoing operations.

Earnings from Avista Energy are derived from the following activities:

- taking speculative positions on future price movements within established risk management policies,
- optimizing generation assets owned by other entities,
- capturing price differences between commodities (spark spread) by converting natural gas into electricity through the power generation process,
- purchasing and storing natural gas for later sales to seek gains from seasonal price variations and demand peaks,
- transmitting electricity and transporting natural gas between locations, including moving energy from lower priced/demand regions to higher priced/demand markets and hub locations, and
- marketing natural gas to end-user industrial and commercial customers.

Avista Energy reports the net margin on derivative commodity instruments held for trading as operating revenues. Revenues from contracts that are not derivatives under SFAS No. 133 and derivative commodity instruments not held for trading are reported on a gross basis in operating revenues. Costs from contracts that are not derivatives under SFAS No. 133 and derivative commodity instruments not held for trading, are reported on a gross basis in resource costs.

The following table presents our net realized gains and net unrealized gains (losses) from Avista Energy for the three months ended March 31 (dollars in thousands):

| | 2007 | 2006 |
|---|---|---|
| Net realized gains | $ 12,615 | $ 5,275 |
| Net unrealized gains (losses) | (20,933) | 6,140 |
| Total gross margin (operating revenues less resource costs) | $ (8,318) | $ 11,415 |

***Overall segment results***

The Energy Marketing and Resource Management segment had a net loss of $7.6 million for the three months ended March 31, 2007 compared to net income of $5.0 million for the three months ended March 31, 2006. These lower results from Avista Energy were primarily due to underperformance on the power side of the business and losses on a power purchase agreement related to the Lancaster Plant. The difference between the estimated market value and the required accounting for certain contracts and physical assets under management accounted for $3.5 million of Avista Energy's net loss for the first quarter of 2007. Our net income for the first quarter of 2006 for this segment was increased by an estimated $2.6 million due to the effects of differences between the estimated market value and the required accounting for certain energy contracts and physical assets under management of Avista Energy.

***Differences in the estimated market value and the required accounting for certain contracts and physical assets under management***

Earnings from this segment are affected by the variability associated with the difference between the estimated market value and the required accounting for certain contracts and physical assets under management of Avista Energy as disclosed above. These operations are managed on an economic basis reflecting contracts and assets under management at estimated market value. Under SFAS No. 133, certain contracts, which are considered derivatives, economically hedge other contracts and physical assets under management, which are not considered derivatives. Our derivative contracts are generally recorded at estimated market value. Non-derivative contracts are generally accounted for at the lower of cost or market value. The accounting treatment does not affect the underlying cash flows or economics of our transactions. This difference between the estimated market value and the required accounting are generally reversed in future periods when market values change or when our contracts are settled or realized. However, the amount of the difference could increase or decrease prior to settlement due to changes in forward market prices. This primarily relates to Avista Energy's management of natural gas inventory and its control of natural gas-fired generation through a power purchase agreement related to the Lancaster Plant. Please refer to the 2006 Form 10-K for a detailed discussion of these differences.

***Analysis of operating revenues, resource costs and gross margin***

Operating revenues decreased $32.1 million due to a decrease of $24.9 million in net trading margin on contracts accounted for under SFAS No. 133 and a $7.2 million decrease from sales of natural gas to commercial and industrial end-user customers (both through Avista Energy Canada and to Montana customers).

Resource costs decreased $12.4 million primarily due to decreased resource costs related to sales of natural gas to commercial and industrial end-user customers, as well as decreased transportation and transmission costs.

Our gross margin (operating revenues less resource costs) from Avista Energy was a loss of $8.3 million for the three months ended March 31, 2007 compared to a gain of $11.4 million for the three months ended March 31, 2006. The decrease was primarily due to underperformance on the power side of the business, losses on the power purchase agreement for the Lancaster Plant, and the difference between the estimated market value and the required accounting for certain contracts and physical assets under management.

Our net realized gains from Avista Energy increased to $12.6 million for the three months ended March 31, 2007 from $5.3 million for the three months ended March 31, 2006. The increase in net realized gains was primarily due to increased net gains on settled financial transactions and decreased transmission and transportation fees.

Our total mark-to-market adjustment from this segment was a net unrealized loss of $20.9 million for the three months ended March 31, 2007 compared to a net unrealized gain of $6.1 million for the three months ended March 31, 2006.

***Energy trading activities and positions***

The following table summarizes information for trading activities at Avista Energy during the three months ended March 31, 2007 (dollars in thousands):

| | Electric Assets net of Liabilities | Natural Gas Assets net of Liabilities | Total Unrealized Gain (Loss) |
|---|---|---|---|
| Fair value of contracts as of December 31, 2006 | $ 34,044 | $ (507) | $ 33,537 |
| Less contracts settled during 2007 (1) | (13,106) | 491 | (12,615) |
| Fair value of new contracts when entered into during 2007 (2) | — | — | — |
| Change in fair value due to changes in valuation techniques (3) | — | — | — |
| Change in fair value attributable to market prices and other market changes | (3,729) | (2,780) | (6,509) |
| Fair value of contracts as of March 31, 2007 | $ 17,209 | $ (2,796) | $ 14,413 |

(1) Contracts settled during 2007 include those contracts that were open in 2006 but settled during the three months ended March 31, 2007 as well as new contracts entered into and settled during 2007. Amount represents net realized gains associated with these settled transactions.

(2) We did not enter into any origination transactions during the three months ended March 31, 2007 in which we recognized any dealer profit or mark-to-market gain or loss at inception.

(3) During the three months ended March 31, 2007, we did not experience a change in fair value due to changes in valuation techniques.

The following table discloses summarized information related to valuation techniques and contractual maturities of energy commodity contracts at Avista Energy outstanding as of March 31, 2007 (dollars in thousands):

| | Less than one year | Greater than one and less than three years | Greater than three and less than five years | Greater than five years | Total |
|---|---|---|---|---|---|
| Electric assets (liabilities), net | | | | | |
| Prices from other external sources (1) | $12,829 | $ 24,599 | $ — | $ — | $ 37,428 |
| Fair value based on valuation models (2) | (873) | (720) | (835) | (17,791) | (20,219) |
| Total electric assets (liabilities), net | $11,956 | $ 23,879 | $ (835) | $(17,791) | $ 17,209 |
| Natural gas assets (liabilities), net | | | | | |
| Prices from other external sources (1) | $ (2,939) | $ 1,856 | $ — | $ — | $ (1,083) |
| Fair value based on valuation models (3) | (897) | (770) | (46) | — | (1,713) |
| Total natural gas assets (liabilities), net | $ (3,836) | $ 1,086 | $ (46) | $ — | $ (2,796) |

(1) We determined fair value based upon actively traded, "over-the-counter" market quotes received from third party brokers. These market quotes are used through 36 months.

(2) Represents contracts for delivery at basis locations not actively traded in the "over-the-counter" markets. In addition, this includes all contracts with a delivery period greater than 36 months, for which active quotes are not available. Our internally developed market curves are determined using a production cost model with inputs for assumptions related to power prices (including, without limitation, natural gas prices, generation on-line, transmission constraints, future demand and weather). We perform frequent stress tests on the valuation of the portfolio. While consistent valuation methodologies and updates to the assumptions are used to capture current market information, changes in these methodologies or underlying assumptions could result in significantly different fair values and income recognition. These same pricing techniques and stress tests are used to evaluate a contract prior to taking a position.

(3) Represents contracts for delivery at basis locations not actively traded in the "over-the-counter" markets. In addition, this includes all contracts with a delivery period greater than 36 months, for which active quotes are not available. Our internally developed market curves are based upon published New York Mercantile Exchange prices, as well as basis spreads using historical and broker estimates.

**Advantage IQ**

Net income for Advantage IQ was $1.6 million for the three months ended March 31, 2007 compared to $1.4 million for the three months ended March 31, 2006. Operating revenues increased $1.9 million and operating expenses increased $1.7 million. The increase in operating revenues was primarily due to the expansion of Advantage IQ's customer base as well as an increase in interest earnings on funds held for customers. Advantage IQ has over 370 customers representing 211,000 billed sites in North America. The number of billed sites increased by 29,000, or 16 percent, from March 31, 2006. The increase in interest earnings on funds held for customers was due in part to an increase in interest rates. The increase in operating expenses primarily reflects increased labor and other operational costs necessary to serve an expanding customer base.

**Other Business Segment**

Net income from this business segment was $0.2 million for the three months ended March 31, 2007 compared to a net loss of $1.1 million for the three months ended March 31, 2006. Operating revenues decreased $0.8 million and operating expenses decreased $1.3 million. Net income for AM&D was $0.1 million for each of the first quarter of 2007 and 2006. With respect to overall segment results, the improvement was due to:

- the accrual for an environmental liability in the first quarter of 2006, and
- gains on certain long-term venture fund investments in this segment in the first quarter of 2007 compared to losses in the first quarter of 2006.

**New Accounting Standards**

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109," (FIN 48) which provides guidance for the recognition and measurement of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 in the first quarter of 2007. The adoption of FIN 48 did not have a cumulative effect on our financial condition and results of operations. See Notes 2 and 8 of the Notes to Consolidated Financial Statements for further information.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. We will be required to adopt SFAS No. 157 in 2008. We are evaluating the impact SFAS No. 157 will have on our financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected would be reported in net income. We will be required to adopt SFAS No. 159 in 2008. We are evaluating the impact SFAS No. 159 will have on our financial condition and results of operations.

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on our consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. Our critical accounting policies that require the use of estimates and assumptions were discussed in detail in the 2006 Form 10-K and have not changed materially from that discussion.

**Liquidity and Capital Resources**

**Review of Cash Flow Statement**

**Overall** During the three months ended March 31, 2007, positive cash flows from operating activities of $90.3 million were used to fund the majority of our cash requirements. These cash requirements included utility property capital expenditures of $40.6 million, debt maturities of $12.3 million and dividends of $7.6 million. As cash flows from operating activities and other sources of cash inflows exceeded other funding requirements, our total debt decreased $15.8 million during the first quarter of 2007.

**Operating Activities** Net cash provided by operating activities was $90.3 million for the three months ended March 31, 2007 compared to $107.1 million for the three months ended March 31, 2006. Net cash provided by working capital components was $26.6 million for the three months ended March 31, 2007, compared to $46.0 million for the three months ended March 31, 2006. The net cash provided during the three months ended March 31, 2007 primarily reflects positive cash flows from:

- accounts receivable (representing net cash received from our customers),
- materials and supplies, fuel stock and natural gas stored (representing the seasonal drawdown of natural gas inventory),
- other current assets (representing a net decrease in income taxes receivable), and
- other current liabilities (representing an increase in interest accrued).

This cash provided was partially offset by negative cash flows from:

- accounts payable (representing net cash paid to our vendors),
- a decrease in the amount outstanding under our revolving accounts receivable sales facility, and
- cash deposits with counterparties (representing cash posted as collateral at Avista Energy).

The net cash provided during the three months ended March 31, 2006 primarily reflected positive cash flows from:

- accounts receivable (representing net cash received from customers),
- other current liabilities (primarily due to an increase in funds held for customers at Avista Advantage), and
- cash deposits with counterparties (representing cash returned that was deposited as collateral funds at Avista Energy).

This was partially offset by a decrease in accounts payable (representing net cash paid to vendors).

Significant non-cash items included $14.9 million of power and natural gas cost amortizations, net of deferrals, for the first quarter of 2007, a decrease from $19.4 million for the first quarter of 2006 primarily due to a decrease in recoveries of previously deferred costs from customers. Significant changes in non-cash items also included a $27.0 million change in the unrealized gain or loss on energy commodity derivatives, representing the change to an unrealized loss of $20.9 million on energy trading activities for the first quarter of 2007 as compared to an unrealized gain of $6.1 million for the first quarter of 2006.

**Investing Activities** Net cash used in investing activities was $39.2 million for the three months ended March 31, 2007, an increase compared to $16.4 million for the three months ended March 31, 2006. This was primarily due to an increase in utility property capital expenditures in 2007 and other cash inflows in the first quarter of 2006, which included the receipt of $5.5 million from our sale of a claim against an affiliate of Enron Corporation related to the construction of Coyote Springs 2 and proceeds from asset sales of $6.8 million (primarily for a turbine at Avista Power).

**Financing Activities** Net cash used in financing activities was $22.3 million for the three months ended March 31, 2007 compared to $45.5 million for the three months ended March 31, 2006. During the first quarter of 2007, our short-term borrowings decreased $4.0 million, which reflects a decrease in the amount of debt outstanding under our $320.0 million committed line of credit. Cash dividends paid increased to $7.6 million (or 14.5 cents per share) for the first quarter of 2007 from $6.8 million (or 14 cents per share) for the first quarter of 2006. Debt maturities were $12.3 million for the first quarter of 2007.

During the three months ended March 31, 2006, short-term borrowings decreased $40.0 million, which reflected a decrease in the amount of debt outstanding under our committed line of credit.

**Overall Liquidity**

Our consolidated operating cash flows are primarily derived from the operations of Avista Utilities and Avista Energy. The primary source of operating cash flows for our utility operations is revenues (including the recovery of previously deferred power and natural gas costs) from sales of electricity and natural gas. Significant uses of cash flows from our utility operations include the purchase of electricity and natural gas, and payment of other operating expenses, taxes and interest. The primary source and use of operating cash flows for Avista Energy is revenues and costs from realized energy commodity transactions as well as cash collateral deposited to or held from counterparties. Significant operating cash outflows for Avista Energy also include other operating expenses and taxes.

Avista Energy has entered into a purchase and sale agreement to sell substantially all of its contracts and ongoing operations to Coral Energy. Proceeds from the sale of Avista Energy's net assets to Coral Energy and liquidation of Avista Energy's remaining net assets (primarily receivables, restricted cash and deposits with counterparties) are expected to result in total proceeds of approximately $175 million. Over time, we plan to redeploy the majority of the proceeds from the transaction into our regulated utility operations by reducing debt and investing in capital assets.

Our operating cash flows do not always fully support the needs for utility capital expenditures. As such, from time to time, we may need to access capital markets in order to fund these needs as well as fund maturing debt. See further discussion at "Capital Resources."

We design operating and capital budgets to control operating costs and capital expenditures, particularly for our regulated utility operations. In addition to operating expenses, we have continuing commitments for capital expenditures for construction, improvement and maintenance of utility facilities.

We will continue to periodically file for rate adjustments for recovery of operating costs and capital investments to provide the opportunity to align our earned returns with those allowed by regulators. We filed a general rate case in Washington in April 2007 requesting general rate increases averaging 15.9 percent for electric and 2.3 percent for natural gas. This is designed to increase annual electric revenues by $51.1 million and annual natural gas revenues by $4.5 million. See further details in the section "Avista Utilities—Regulatory Matters."

With respect to our utility operations, when power and natural gas costs exceed the levels currently recovered from retail customers, net cash flows are negatively affected. Factors that could cause purchased power costs to exceed the levels currently recovered from our customers include, but are not limited to, higher prices in wholesale markets when we are buying energy or an increased need to purchase power in the wholesale markets. Factors beyond our control that could result in an increased need to purchase power in the wholesale markets include, but are not limited to:

- increases in demand (either due to weather or customer growth),
- low availability of streamflows for hydroelectric generation,
- outages at generating facilities, and
- failure of third parties to deliver on energy or capacity contracts.

Our hydroelectric generation was 104 percent of normal in 2006. For 2007, we are forecasting hydroelectric generation to be normal. This 2007 forecast will change based upon precipitation, temperatures and other variables during the year.

We monitor the potential liquidity impacts of increasing energy commodity prices for both our utility operations (Avista Utilities) and our energy marketing and resource management operations (Avista Energy). We believe that we have adequate liquidity to meet the increased cash needs of higher energy commodity prices through our:

- current cash and cash equivalents,
- $320.0 million committed line of credit at Avista Corp. (Avista Utilities), and
- $145.0 million committed line of credit at Avista Energy (through the expected closing of its operations).

Our utility has regulatory mechanisms in place that provide for the deferral and recovery of the majority of power and natural gas supply costs. However, if prices increase, deferral balances will increase, which will negatively affect our cash flow and liquidity until such costs, with interest, are recovered from customers.

**Capital Resources**

Our consolidated capital structure, including the current portion of long-term debt and short-term borrowings, consisted of the following as of March 31, 2007 and December 31, 2006 (dollars in thousands):

| | March 31, 2007 | | December 31, 2006 | |
|---|---|---|---|---|
| | Amount | Percent of total | Amount | Percent of total |
| Current portion of long-term debt | $ 14,607 | 0.7% | $ 26,605 | 1.3% |
| Short-term borrowings | — | — | 4,000 | 0.2 |
| Long-term debt to affiliated trusts | 113,403 | 5.6 | 113,403 | 5.6 |
| Long-term debt | 950,053 | 46.8 | 949,854 | 46.6 |
| Total debt | 1,078,063 | 53.1 | 1,093,862 | 53.7 |
| Preferred stock-cumulative (including current portion) | 26,250 | 1.3 | 26,250 | 1.3 |
| Total liabilities | 1,104,313 | 54.4 | 1,120,112 | 55.0 |
| Stockholders' equity | 927,274 | 45.6 | 916,846 | 45.0 |
| Total | $2,031,587 | 100.0% | $2,036,958 | 100.0% |

Our total debt decreased $15.8 million during the first quarter of 2007 primarily due to:

- the payment of maturing debt with operating cash flows and other sources of funds, and
- a decrease in the amount outstanding on our committed line of credit.

We need to finance capital expenditures and obtain additional working capital from time to time. The cash requirements needed to service our indebtedness, both short-term and long-term, reduces the amount of cash flow available to fund working capital, purchased power and natural gas costs, capital expenditures, dividends and other requirements. Our stockholders' equity increased $10.4 million during the first quarter of 2007 primarily due to net income and other comprehensive income, partially offset by dividends.

We generally fund capital expenditures with a combination of internally generated cash and external financing. The level of cash generated internally and the amount that is available for capital expenditures fluctuates depending on a variety of factors. Cash provided by our utility operating activities and cash generated by the Avista Energy transaction (including the sale of net assets to Coral Energy and liquidation of net current assets not sold to Coral Energy) are expected to be the primary sources of funds for operating needs, dividends, capital expenditures, as well as maturing long-term debt and preferred stock for 2007. Borrowings under our $320.0 million committed line of credit may supplement these funds to the extent necessary.

We have $358 million of long-term debt maturities and mandatory preferred stock redemptions in 2007 and 2008. Our forecasts indicate that we will need to issue new securities to fund a portion of these requirements in 2008. Proceeds from the expected Avista Energy transaction should reduce our need to issue new securities in 2008. In 2004, we entered into forward-starting interest rate swap agreements effectively locking in market fixed interest rates, which were relatively low compared to historical interest rates, for $125 million of our forecasted debt issuances in 2008.

We have a $320.0 million committed line of credit agreement with various banks with an expiration date of April 5, 2011. Under the agreement, we can request the issuance of up to $320.0 million in letters of credit. As of March 31, 2007, we did not have any borrowings outstanding, a decrease from $4.0 million as of December 31, 2006. As of March 31, 2007, there were $45.3 million in letters of credit outstanding, a decrease from $77.1 million as of December 31, 2006. The committed line of credit is secured by $320.0 million of non-transferable First Mortgage Bonds issued to the agent bank. Such First Mortgage Bonds would only become due and payable in the event, and then only to the extent, that we default on obligations under the committed line of credit.

Our committed line of credit agreement contains customary covenants and default provisions, including a covenant requiring the ratio of "earnings before interest, taxes, depreciation and amortization" to "interest expense" of Avista Utilities for the preceding twelve-month period at the end of any fiscal quarter to be greater than 1.6 to 1. As of March 31, 2007, we were in compliance with this covenant with a ratio of 2.45 to 1. The committed line of credit agreement also has a covenant which does not permit our ratio of "consolidated total debt" to "consolidated total capitalization" to be greater than 70 percent at the end of any fiscal quarter. This ratio limitation will be increased to 75 percent during the period between the completion of the proposed change in our corporate organization (see Note 13) and December 31, 2007. As of March 31, 2007, we were in compliance with this covenant with a ratio of 53.1 percent. If the proposed change in organization becomes effective, the committed line of credit agreement will remain at Avista Corp. (Avista Utilities).

Any default on the line of credit or other financing arrangements of Avista Corp. or any of our significant subsidiaries could result in cross-defaults to other agreements of such entity, and/or to the line of credit or other financing arrangements of any other of such entities. Any defaults could also induce vendors and other counterparties to demand collateral. In the event of any such default, it would be difficult for us to obtain financing on reasonable terms to pay creditors or fund operations. We would also likely be prohibited from paying dividends on our common stock. We do not guarantee the indebtedness of any of our subsidiaries. As of March 31, 2007, Avista Corp. and our subsidiaries were in compliance with all of the covenants of our financing agreements.

As further discussed at "Avista Utilities - Regulatory Matters," in December 2005, the WUTC issued an order approving the settlement agreement reached in our Washington general rate case with certain conditions. We agreed to increase the utility equity component to 35 percent by the end of 2007 and to 38 percent by the end of 2008. As further discussed at "Note 13 of the Notes to the Consolidated Financial Statements," the IPUC accepted a stipulation that we entered with the IPUC Staff that sets forth a variety of conditions related to the implementation of our holding company structure. One of the conditions provides for the same utility equity components that are required in our Washington general rate case. If we do not meet those targets, it could result in a reduction in base rates of 2 percent for each target in each of Washington and Idaho. We have also entered into a settlement agreement in Washington related to our proposed holding company formation. In this settlement agreement, we have committed to increase the utility equity component to 40 percent by June 30, 2008. However, the provision to reduce base rates by 2 percent does not apply if we fail to meet this target. The utility equity component was 39.5 percent as of March 31, 2007. We should be able to meet these equity targets through expected earnings and proceeds from the Avista Energy transaction.

In December 2006, we entered into a sales agency agreement with a sales agent, to issue up to 2 million shares of our common stock from time to time. Due to the expected proceeds from the sale and liquidation of Avista Energy's assets, we are not currently planning to issue any shares under this agreement.

**Off-Balance Sheet Arrangements**

Avista Receivables Corporation (ARC) is our wholly owned, bankruptcy-remote subsidiary formed for the purpose of acquiring or purchasing interests in certain of our accounts receivable, both billed and unbilled. On March 19, 2007, Avista Corp., ARC and a third-party financial institution amended a Receivables Purchase Agreement. The most significant amendment was to extend the termination date from March 20, 2007 to March 17, 2008. The Receivables Purchase Agreement was originally entered into on May 29, 2002 and provides us with cost-effective funds for:

- working capital requirements,
- capital expenditures, and
- other general corporate needs.

Under the Receivables Purchase Agreement, ARC can sell without recourse, on a revolving basis, up to $85.0 million of our receivables. ARC is obligated to pay fees that approximate the purchaser's cost of issuing commercial paper equal in value to the interests in receivables sold. The Receivables Purchase Agreement has financial covenants, which are substantially the same as those of our $320.0 million committed line of credit. As of March 31, 2007, we had sold $68.0 million in accounts receivable under this revolving agreement.

**Credit Ratings**

The following table summarizes our credit ratings as of May 3, 2007:

| | Standard & Poor's | Moody's | Fitch, Inc. |
|---|---|---|---|
| Avista Corporation | | | |
| Corporate/Issuer rating | BB+ | Ba1 | BB |
| Senior secured debt | BBB- | Baa3 | BBB- |
| Senior unsecured debt | BB+ | Ba1 | BB+ |
| Preferred stock | BB- | Ba3 | BB |
| Avista Capital II (1) | | | |
| Preferred Trust Securities | BB- | Ba2 | BB |
| AVA Capital Trust III (1) | | | |
| Preferred Trust Securities | BB- | Ba2 | BB |
| Rating outlook | Positive (2) | Stable | Positive |

(1) Only assets are subordinated debentures of Avista Corporation.
(2) Changed to positive from stable in April 2007.

These security ratings are not recommendations to buy, sell or hold securities. The ratings are subject to change or withdrawal at any time by the respective credit rating agencies. Each credit rating should be evaluated independently of any other ratings.

**Pension Plan**

As of March 31, 2007, our pension plan had assets with a fair value that was less than the benefit obligation under the plan. We contributed $15 million to the pension plan in 2006. We are planning to contribute $15 million to the pension plan in 2007 ($3.75 million was contributed during the first quarter of 2007). Our total pension plan contributions were $73 million from 2002 through the first quarter of 2007.

The Pension Protection Act of 2006 (the Pension Act) was signed into law in August 2006. The Pension Act provides new funding rules for pension plans to improve the funded status of corporate defined benefit plans. The new funding rules could increase our minimum required cash contributions to the pension plan in the future. The legislation is effective in 2008; however, the law contains a transition period related to the funding rules. We do not expect the Pension Act to have a material effect on our financial condition, results of operations or cash flows.

**Dividends**

The Board of Directors considers the level of dividends on our common stock on a regular basis, taking into account numerous factors including, without limitation:

- our results of operations, cash flows and financial condition,
- the success of our business strategies, and
- general economic and competitive conditions.

Our net income available for dividends is derived primarily from our regulated utility operations (Avista Utilities) and Avista Energy.

The payment of dividends on common stock is restricted by provisions of certain covenants applicable to preferred stock contained in our Restated Articles of Incorporation, as amended, and to long-term debt contained in various indentures. Covenants under the 9.75 percent Senior Notes that mature in 2008 limit our ability to increase common stock cash dividends to no more than 5 percent over the previous quarter, unless certain conditions are met related to restricted payments. As of March 31, 2007, we are meeting the conditions that would allow us to increase the common stock cash dividend in excess of 5 percent over the previous quarter.

As further discussed at “Note 13 of the Notes to the Consolidated Financial Statements,” the IPUC accepted a stipulation that we entered with the IPUC Staff that sets forth a variety of conditions related to the implementation of our holding company structure. One of the conditions requires IPUC approval of any dividend to the holding company that would reduce utility common equity below 25 percent. Furthermore, we have entered into a similar agreement with the WUTC Staff. This agreement would require WUTC approval of any dividend to the holding company that would reduce utility common equity below 30 percent.

Avista Energy holds a significant portion of cash and cash equivalents reflected on our Consolidated Balance Sheets. Covenants in Avista Energy’s credit agreement, certain counterparty agreements and market liquidity conditions result in Avista Energy maintaining certain levels of cash and therefore effectively limit the amount of cash dividends that are available for distribution to Avista Capital and ultimately to Avista Corp. Avista Energy’s cash and restricted cash will be available for dividends to Avista Capital following the sale of contracts to Coral Energy and the liquidation of Avista Energy’s remaining net assets. We are expecting to generate approximately $175 million in cash proceeds from the transaction including the liquidation of Avista Energy’s net current assets not sold to Coral Energy (primarily receivables, restricted cash and deposits with counterparties).

**Avista Utilities Operations**

As of March 31, 2007, we had $2.0 million of restricted cash at Avista Corp. /Avista Utilities. The restricted cash relates to deposits for interest rate swap agreements.

Our utility held cash deposits from other parties in the amount of $38.8 million as of March 31, 2007, which is included in deposits from counterparties on the Consolidated Balance Sheet. These amounts are subject to return if conditions warrant because of continuing portfolio value fluctuations with those parties or substitution of collateral.

See “Notes 9 and 10 of Notes to Consolidated Financial Statements” for additional details related to our financing activities.

**Energy Marketing and Resource Management (Avista Energy) Operations**

Avista Energy, and its subsidiary, Avista Energy Canada, as co-borrowers, have a committed credit agreement with a group of banks in the aggregate amount of $145.0 million with an expiration date of July 12, 2007. Avista Energy anticipates that the credit agreement will be extended if necessary and terminated with the closing of the sale of contracts and ongoing operations to Coral Energy. This committed credit facility provides for the issuance of letters of credit to secure contractual obligations to counterparties and for cash advances. This facility is secured by the assets of Avista Energy and Avista Energy Canada, and guaranteed by Avista Capital and by CoPac Management, Inc., a wholly owned subsidiary of Avista Energy Canada. The maximum amount of credit extended by the banks for the issuance of letters of credit is the subscribed amount of the facility less the amount of outstanding cash advances, if any. The maximum amount available for cash advances under the credit agreement is $50.0 million. No cash advances were outstanding as of March 31, 2007. Letters of credit in the aggregate amount of $20.6 million were outstanding as of March 31, 2007. The cash deposits of Avista Energy at the respective banks collateralized these letters of credit as of March 31, 2007, which is reflected as restricted cash on our Consolidated Balance Sheets.

Avista Energy’s credit agreement contains covenants and default provisions, including covenants to maintain “minimum net working capital” and “minimum net worth,” as well as a covenant limiting the amount of indebtedness that the co-borrowers may incur. The credit agreement also contains covenants and other restrictions related to the co-borrowers’ trading limits and positions, including VAR limits, restrictions with respect to changes in risk management policies or volumetric limits, and limits on exposure related to hourly and daily trading of electricity. These covenants, certain counterparty agreements and market liquidity conditions result in Avista Energy maintaining certain levels of cash and therefore effectively limit the amount of cash dividends that are available for distribution to Avista Capital and ultimately to Avista Corp. Avista Energy was in compliance with the covenants of its credit agreement as of March 31, 2007.

Avista Capital provides guarantees for Avista Energy’s credit agreement (see discussion above) and, in the course of business, may provide performance guarantees to other parties with whom Avista Energy may be doing business. At any point in time, Avista Capital is only liable for the outstanding portion of the performance guarantee, which was $32.5 million as of March 31, 2007. The face value of all performance guarantees issued by Avista Capital for energy trading contracts at Avista Energy was $366.9 million as of March 31, 2007.

As part of its cash management practices and operations, Avista Energy from time to time makes unsecured short-term loans to its parent, Avista Capital. Avista Capital’s Board of Directors has limited the total outstanding indebtedness to no more than $45.0 million. Further, as required under Avista Energy’s credit facility, such loans cannot be outstanding longer than 90 days without being repaid. During the first quarter of 2007, Avista Energy’s maximum total outstanding short-term loan to Avista Capital was $26.0 million. As of March 31, 2007, all outstanding loans including accrued interest had been repaid.

Avista Energy manages collateral requirements with counterparties by providing letters of credit, providing guarantees from Avista Capital, depositing cash with counterparties and offsetting transactions with counterparties. Cash deposited with counterparties totaled $85.4 million as of March 31, 2007, an increase from $79.5 million as of December 31, 2006. Avista Energy held cash deposits from other parties in the amount of $2.2 million as of March 31, 2007, which is included in deposits from counterparties on our Consolidated Balance Sheet. These amounts are subject to return if conditions warrant because of continuing portfolio value fluctuations with those parties or substitution of collateral. Such deposits to and from counterparties will be returned following the sale of Avista Energy’s contracts to Coral Energy.

As of March 31, 2007, Avista Energy had $52.9 million in cash, as well as $24.2 million of restricted cash.

**Contractual Obligations**

During the three months ended March 31, 2007, our future contractual obligations have not changed materially from the amounts disclosed in the 2006 Form 10-K with the following exceptions:

The amount outstanding under our revolving accounts receivable sales financing facility decreased from $85.0 million as of December 31, 2006 to $68.0 million as of March 31, 2007. In March 2007, the termination date of this facility was extended from March 20, 2007 to March 17, 2008.

Avista Energy's contractual commitments to purchase energy commodities as well as commitments related to transmission, transportation and other energy-related contracts in future periods were as follows as of March 31, 2007 (dollars in millions):

| For the 12-month period ended March 31, | 2008 | 2009 | 2010 | 2011 | 2012 | Thereafter |
|---|---|---|---|---|---|---|
| Energy purchase contracts | $418 | $263 | $215 | $158 | $35 | $ 357 |

Avista Energy also has sales commitments related to these contractual obligations in future periods. The majority of these contractual commitments will be assumed by Coral Energy.

**Business Risk**

Our operations are exposed to risks including, but not limited to:

- market prices and supply of wholesale energy, which we purchase and sell, including power, fuel and natural gas,
- regulatory allowance of the recovery of power and natural gas costs, operating costs and capital investments,
- streamflow and weather conditions,
- the effects of changes in legislative and governmental regulations,
- changes in regulatory requirements,
- availability of generation facilities,
- competition,
- technology, and
- availability of funding.

Also, like other utilities, our facilities and operations are exposed to natural disasters and terrorism risks or other malicious acts. See further reference to risks and uncertainties under "Forward-Looking Statements."

Our business risk has not materially changed during the three months ended March 31, 2007. However, our risk profile related to Avista Energy's operations is expected to change with the closing of the sale of contracts and ongoing operations to Coral Energy. Please refer to the 2006 Form 10-K for further description and analysis of business risk including, but not limited to, commodity price, credit, other operating, interest rate and foreign currency risks.

**Risk Management**

***Risk Policies and Oversight***

In our utility operation and at Avista Energy, we use a variety of techniques to manage risks for energy resources and wholesale energy market activities. We have risk management policies and procedures to manage these risks, both qualitative and quantitative. Please refer to the 2006 Form 10-K for discussion of risk management policies and procedures.

***Quantitative Risk Measurements***

Avista Energy measures the risk in its electric and natural gas portfolio daily utilizing a Value-at-Risk (VAR) model, which monitors its risk in comparison to established thresholds. Please refer to the 2006 Form 10-K for further discussion of the VAR model. As of March 31, 2007, Avista Energy's estimated potential one-day unfavorable impact on gross margin as measured by VAR was $0.4 million, compared to $0.4 million as of December 31, 2006. The average daily VAR for the three months ended March 31, 2007 was $0.7 million. The high daily VAR was $1.1 million and the low daily VAR was $0.3 million during the three months ended March 31, 2007. Avista Energy was in compliance with its one-day VAR limits during the three months ended March 31, 2007. Changes in markets inconsistent with historical trends or assumptions used could cause actual results to exceed predicted limits.

**Environmental Issues and Other Contingencies**

We are subject to environmental regulation by federal, state and local authorities. The generation, transmission, distribution, service and storage facilities in which we have an ownership interest were designed to comply with all applicable environmental laws.

We monitor legislative developments at both the state and national level with respect to environmental issues, particularly those related to the potential for further restrictions on the operation of our generating plants.

Current environmental laws and regulations have, and future modifications may have, the effect of:

- increasing the lead time for the construction of new generating plants,
- requiring modification of our existing generating plants,
- increasing the risk of delay on construction projects,
- reducing the amount of energy available from our generating plants, and
- restricting the types of generating plants that can be built.

As such, compliance with such environmental laws and regulations could result in increases to capital expenditures and operating expenses. However, we intend to seek recovery of incurred costs through the rate making process.

Long-term global climate changes, particularly with respect to the Pacific Northwest, could have a significant effect on our business. Changing temperatures and precipitation, including snowpack conditions, affect the availability and timing of hydroelectric generation capacity. Changing temperatures could also increase or decrease customer demand. Our operations could also be affected by any legislative or regulatory developments in response to global climate changes, including restrictions on the operation of our power generation resources.

We continue to monitor and evaluate the possible adoption of national, regional, or state greenhouse gas requirements. In particular, a greenhouse gas bill has been passed by the legislature in the state of Washington and bills have been introduced in the U. S. Senate and House of Representatives.

The greenhouse gas bill passed by the legislature in the state of Washington would place significant restrictions on greenhouse gas emissions from any new generation plants built in the state of Washington. Furthermore, utilities would be prevented from entering into contracts to purchase energy produced by plants in other states that do not meet the same restrictions. Currently, the only type of thermal generating plants that meet these restrictions are combined-cycle natural gas-fired generation turbines. This greenhouse gas bill sets goals to reduce emissions in the state of Washington to 1990 levels by 2020; to 25 percent below 1990 levels by 2035; and to 50 percent below 1990 levels by 2050.

Greenhouse gas requirements could result in significant costs for us to comply with restrictions on carbon dioxide or other greenhouse gas emissions. Such requirements could also preclude us from developing certain types of generating plants, including coal-fired plants.

Initiative Measure 937 (I-937) was passed into law through the General Election in Washington in November 2006. I-937 requires certain investor-owned, cooperative, and government-owned electric utilities (including Avista Corp.) to acquire new renewable energy resources and/or renewable energy credits in incremental amounts until those resources or credits equal 15 percent of the utility's total retail load in 2020. I-937 also requires these utilities to meet biennial energy conservation targets beginning in 2012. Failure to comply with renewable energy and conservation standards will result in penalties of at least $50 per MWh being assessed against a utility for each MWh it is deficient in meeting a standard. A utility would be deemed to comply with the renewable energy standard if it invests at least 4 percent of its total annual retail revenue requirement on the incremental costs of renewable resources and/or renewable credits. Our most recent Electric Integrated Resource Plan (IRP) includes the acquisition of additional renewable resources such that, if the IRP is implemented, we would be compliant with the requirement by 2020 assuming that such renewable resources were cost effective. The amount of renewable resources in our future IRPs could change if the cost effectiveness of those resources changes.

For other environmental issues and other contingencies see "Note 12 of the Notes to Consolidated Financial Statements."

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

See "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations: – Business Risk and – Risk Management," "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – Energy Marketing and Resource Management – Energy trading activities and positions," and "Note 6 of the Notes to Consolidated Financial Statements."

**Item 4. Controls and Procedures**

The Company has disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) to ensure that information required to be disclosed in the reports it files or submits under the Act is recorded, processed, summarized and reported on a timely basis. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Act is accumulated and communicated to the

Company's management, including its principal executive and principal financial officers as appropriate to allow timely decisions regarding required disclosure. Under the supervision and with the participation of the Company's management, including the Company's principal executive officer and principal financial officer, the Company has evaluated its disclosure controls and procedures as of the end of the period covered by this report. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon the Company's evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective at a reasonable assurance level as of March 31, 2007.

There have been no changes in the Company's internal control over financial reporting that occurred during the first quarter of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Part II. Other Information

### Item 1. Legal Proceedings

See "Note 12 of the Notes to Consolidated Financial Statements" which is incorporated by reference.

### Item 1A. Risk Factors

Please refer to the 2006 Form 10-K for disclosure of risk factors that could have a significant impact on our operations, results of operations, financial condition or cash flows and could cause actual results or outcomes to differ materially from those discussed in our reports filed with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q), and elsewhere. These risk factors have not materially changed from the disclosures provided in the 2006 Form 10-K.

Our risk factors related to Avista Energy's operations are expected to change with the closing of the sale of contracts and ongoing operations to Coral Energy as many of the risk factors specifically related to Avista Energy would be eliminated.

In addition to these risk factors, please also see "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements" for additional factors which could have a significant impact on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements.

### Item 6. Exhibits

| | |
|---|---|
| 10.1 | Purchase and Sale Agreement by and among Avista Energy, Inc. and Avista Energy Canada, Ltd. as Sellers and Coral Energy Holding, L.P., Coral Energy Resources, L.P., Coral Power, L.L.C. and Coral Energy Canada Inc. as Purchasers dated as of April 16, 2007* |
| 12 | Computation of ratio of earnings to fixed charges and preferred dividend requirements* |
| 15 | Letter Re: Unaudited Interim Financial Information* |
| 31.1 | Certification of Chief Executive Officer* |
| 31.2 | Certification of Chief Financial Officer* |
| 32 | Certification of Corporate Officers (Furnished Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)** |

* Filed herewith.
** Furnished herewith.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVISTA CORPORATION
(Registrant)

Date: May 4, 2007

/s/ Malyn K. Malquist
Malyn K. Malquist
Executive Vice President and Chief Financial Officer
(Principal Accounting and Financial Officer)

**Exhibit 10.1**

# PURCHASE AND SALE AGREEMENT

by and among

**Avista Energy, Inc. and Avista Energy Canada, Ltd.**

as Sellers

and

**Coral Energy Holding, L.P., Coral Energy Resources, L.P., Coral Power, L.L.C. and Coral Energy Canada Inc.**

as Purchasers

Dated as of April 16, 2007

**TABLE OF CONTENTS**

**Exhibits**

**PURCHASE AND SALE AGREEMENT**

This Purchase and Sale Agreement ("**Agreement**"), dated as of April 16, 2007 is made and entered into by and among **Avista Energy, Inc.**, a Washington corporation ("**Avista Energy**") and Avista Energy Canada, Ltd. an amalgamated corporation of the Province of Alberta, Canada ("**Avista Canada**") (collectively, "**Sellers**"), and **Coral Energy Holding, L.P.**, a Delaware limited partnership ("**Coral Holding**"), **Coral Energy Resources, L.P.**, a Delaware limited partnership ("**Coral Resources**"), **Coral Power, L.L.C.**, a Delaware limited liability company ("**Coral Power**") and **Coral Energy Canada Inc**., a corporation organized under the laws of the Province of Alberta, Canada ("**Coral Canada**") (collectively, "**Purchasers**").

**RECITALS**

**WHEREAS**, Sellers desire to sell and assign to Purchasers and Purchasers desire to buy and accept from Sellers substantially all of the active, operating assets owned and used by Sellers in the operation of the business.

**NOW THEREFORE**, in consideration of the premises and the mutual covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

**AGREEMENT**

1. **Agreement and Interpretation.**

1.1. **Definitions.**

Capitalized terms used in this Agreement have the meanings given to them in **Appendix A** to this Agreement.

1.2. **Construction.**

1.2.1. All article, section, subsection, schedule, appendix and exhibit references used in this Agreement are to articles, sections, subsections, schedules, appendices and exhibits to this Agreement unless otherwise specified. The appendices, exhibits and schedules attached to this Agreement constitute a part of this Agreement and are incorporated herein and made a part hereof for all purposes.

1.2.2. If a term is defined as one part of speech (such as a noun), it shall have a corresponding meaning when used as another part of speech (such as a verb). Unless the context of this Agreement clearly requires otherwise, the singular shall include the plural and the plural shall include the singular wherever and as often as may be appropriate. Words importing the masculine gender shall include the feminine and neutral genders and *vice versa*. The words "includes" or "including" shall mean "including without limitation." The rule *ejusdem generis* may not be invoked to restrict or limit the scope of the general term or phrase followed or preceded by an enumeration of particular examples. The words "hereof," "hereby," "herein," "hereunder" and similar terms in this Agreement shall refer to this Agreement as a whole and not any particular section or article in which such words appear, unless the context of this Agreement clearly requires otherwise. Any reference to a Law shall include any amendment thereof or any successor thereto and any rules and regulations promulgated thereunder, as the same may be in effect from time to time. Currency amounts referenced herein, unless otherwise specified, are in U.S. Dollars.

1.2.3. Time is of the essence in this Agreement. Whenever this Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified. Whenever any action must be taken hereunder on or by a day that is not a Business Day, then such action may be validly taken on or by the next day that is a Business Day. Any reference to time shall be deemed to be the local time in Spokane, Washington.

1.2.4. All accounting terms used herein and not expressly defined herein shall have the meanings given to them under GAAP.

1.2.5. Any amount owed by one Party to another Party hereunder that is not paid by the applicable due date shall bear interest at the Applicable Rate.

1.2.6. Each Party acknowledges that it and its attorneys have been given an equal opportunity to negotiate the terms and conditions of this Agreement and that any rule of construction to the effect that ambiguities are to be resolved against the drafting Party or any similar rule operating against the drafter of an agreement shall not be applicable to the construction or interpretation of this Agreement.

## 2. Purchase and Sale Transaction.

### 2.1. Purchase and Sale.

Subject to the terms and conditions set forth in this Agreement, the Parties agree that as of the Effective Time, Sellers shall sell, assign, transfer, convey, deliver and release to Purchasers free and clear of all Liens and liabilities (except for Permitted Liens and the Assumed Liabilities) and Purchasers shall purchase, accept and assume from Sellers, all of Sellers' right, title and interest in and to the Acquired Assets and the Assumed Liabilities. Each of the Parties understands and agrees that Purchasers are not acquiring or assuming and have no interest in or obligation with respect to the Excluded Assets and the Retained Liabilities.

### 2.2. Purchase Price.

2.2.1. Purchasers shall pay to Sellers, as consideration for the assignment to and assumption by Purchasers of the Acquired Assets and the Assumed Liabilities related thereto, the "**Purchase Price**," which shall be calculated as follows:

(a) The Net Trade Book Value calculated as of the Effective Time in accordance with past practice; plus

(b) The net book value of all furniture, office equipment and select software, hardware, telemetry and other communications equipment (the "**Tangible Assets**") being acquired as reflected on Sellers' balance sheet as of the Effective Time calculated in accordance with past practice; plus

(c) The Market Value of the Natural Gas Inventory owned by Sellers as of the Effective Time; minus

(d) Any adjustment calculated as set forth on Schedule 2.2.1(d).

2.2.2. Payment of Purchase Price

(a) At least ten (10) Business Days prior to the anticipated Closing Date, Sellers shall deliver to Purchasers the following:

(i) A statement setting forth in reasonable detail the "**Estimated Purchase Price,**" which shall be calculated as follows:

A. An amount equal to 90% of the Net Trade Book Value as calculated by Sellers as of the Estimate Date; plus

B. An amount equal to the net book value of the Tangible Assets as of the Estimate Date; plus

C. An amount equal to the Market Value of the Natural Gas Inventory owned by Sellers as of the Estimate Date.

(ii) Documentation supporting the calculation of the Estimated Purchase Price, including the Electronically Recorded Trade Book, a schedule listing the Manually Recorded Commodity Transactions, and a schedule setting forth the energy commodity assets and energy commodity liabilities included in Net Trade Book Value, in each case as of the Estimate Date.

(b) On the first Business Day following the Effective Time, Purchasers shall remit to Sellers via wire transfer the amount of the Estimated Purchase Price less any adjustment calculated as set forth on Schedule 2.2.1(d) and, subject to Section 2.7, any Canadian withholding tax, if applicable. In addition, within seven (7) Business Days following the Effective Time, the Parties will effect the payment, if any, described in Section 5.10.2.

(c) On the first Business Day following the Effective Time, Purchasers shall deliver the Canadian Withholding Tax Escrow Amount to the Canadian Withholding Tax Escrow Agent as provided in Section 2.7.

(d) Within ten (10) Business Days following the Effective Time, Sellers shall in good faith provide to Purchasers its calculation of the Purchase Price as of the Effective Time, together with any supporting documentation. Within ten (10) Business Days following receipt of this Purchase Price calculation and supporting materials, Purchasers shall notify Sellers in writing as to whether it accepts Sellers' calculation of the Purchase Price or provide Sellers with a detailed explanation as to why it is disputing Sellers' calculation of the Purchase Price. Failing delivery of such notice within such ten (10) Business Day period, Purchasers shall be deemed conclusively to have accepted Sellers' calculation of the Purchase Price.

(e) If Purchasers agree with Sellers' calculation of the Purchase Price and if the Purchase Price exceeds the Estimated Purchase Price (less any adjustment calculated as set forth on Schedule 2.2.1(d)), Purchasers shall remit such difference to Sellers within two (2) Business Days of receipt of Purchasers' acceptance of the Purchase Price calculation plus interest on such amount calculated at the Applicable Rate from the Closing Date until the date of payment. If the Estimated Purchase Price (less any adjustment calculated as set forth on Schedule 2.2.1(d)) exceeds the Purchase Price, then Sellers shall remit such difference to Purchasers within two (2) Business Days of receipt of Purchasers notification of acceptance of the Purchase Price calculation plus interest on such amount calculated at the Applicable Rate from the Closing Date until the date of payment.

(f) If Purchasers disagree with Sellers' calculation of the Purchase Price as set forth in Section 2.2.2(d), the Parties will promptly enter into good faith discussions to resolve the differences. If such discussions have not resolved the dispute within thirty (30) days from the date on which the notice of the dispute was given by Purchasers to Sellers as provided in Section 2.2.2(d), the matter shall be submitted to the chief executive officers of each of the Parties for resolution. If such chief executive officers have not resolved the dispute within fifteen (15) days of the expiration of the prior thirty (30) day period, the Parties will submit the matter for a determination to Ernst & Young, LLP, and if Ernst & Young, LLP is unwilling or unable to perform, the dispute will be referred to KPMG LLP, and if KPMG LLP is unable or unwilling to perform, to such other firm of nationally recognized independent certified public accounts as may be acceptable to the Parties (the "**Arbitrator**"). The Parties shall promptly make available to the Arbitrator such information and persons as may be requested by the Arbitrator for purposes of making its determination and shall otherwise cooperate with the Arbitrator as fully as reasonably possible. The Arbitrator shall calculate the Purchase Price in the manner as set forth in Section 2.2 and base its decision on the historical method for calculating the Net Trade Book Value and

the Commodity Valuation Methodology. The determination of the Arbitrator shall be binding upon the Parties, without the right to appeal or review. If the Purchase Price as determined by the Arbitrator exceeds the Estimated Purchase Price (less any adjustment calculated as set forth on Schedule 2.2.1(d)), Purchasers shall remit such difference to Sellers within two (2) Business Days of written receipt of the Arbitrator's decision plus interest on such amount calculated at the Applicable Rate from the Closing Date until the date of payment. If the Estimated Purchase Price (less any adjustment calculated as set forth on Schedule 2.2.1(d)) exceeds the Purchase Price as determined by the Arbitrator, then Sellers shall remit such difference to Purchasers within two (2) Business Days of written receipt of the Arbitrator's decision plus interest on such amount calculated at the Applicable Rate from the Closing Date until the date of payment. Sellers and Purchasers shall each pay one half of the fees and costs of the Arbitrator.

(g) Any remittances required under Sections 2.2.2(d)-(f) herein shall be increased or decreased, as the case may be, to properly reflect the amount of Canadian withholding tax required to be withheld after taking into consideration the amount of such tax withheld pursuant to Section 2.2.2(c). To the extent that additional withholding tax is required, Purchasers shall withhold such additional amounts as required and remit such amounts in accordance with the provisions of Section 2.7 on the same day as any additional Purchase Price is remitted to Sellers.

2.3. **Assumption of Liabilities and Obligations.**

Immediately after the Effective Time, and subject to Section 2.6, Purchasers shall assume and undertake to pay, discharge and perform all of the Assumed Liabilities. Purchasers are not assuming and shall not be responsible for, either directly or indirectly, any Retained Liabilities, all of which shall remain the responsibility of Sellers.

2.4. **Interstate Pipeline and Storage Contracts.**

Section 3.8 of the Seller Disclosure Schedule includes those Assigned Contracts that are firm transportation contracts with pipelines located in the United States ("**U.S. Pipelines**") subject to the jurisdiction of the FERC ("**Interstate Pipeline and Storage Contracts**"), the transfer of which to Purchasers will be subject to the FERC's capacity release rules and related interstate pipeline tariff provisions. Effective as of the Effective Time and subject to the terms of this Agreement as well as applicable rules and regulations and tariff provisions of the U.S. Pipelines, Sellers hereby agree to permanently release, and Purchasers hereby agree to assume, the Interstate Pipeline and Storage Contracts on a prearranged basis for their full remaining terms at maximum rate, except for Interstate Pipeline and Storage Contracts that are contracted at a discounted or negotiated rate. If required under any applicable Law or tariff, Sellers shall post for public bid any Interstate Pipeline and Storage Contracts that it holds that are contracted at a discounted rate at such discounted rate. At least one Purchaser agrees to bid on such contract at the discounted or negotiated rate. Sellers and Purchasers agree to comply with all applicable laws and all applicable provisions and procedures of the U.S. Pipelines' tariffs necessary to enable Purchasers to take direct, permanent assignment of the Interstate Pipeline and Storage Contracts. The applicable Purchaser agrees to promptly execute any revised or amended service agreements tendered to it by any of the U.S. Pipelines, each with a term beginning on the Effective Time and continuing through the remaining term of each respective Interstate Pipeline and Storage Contract. These revised or amended service agreements will be deemed null and void if this Agreement is terminated pursuant to Section 9, and, if necessary, Purchasers will reassign and Sellers will accept reassignment of the Interstate Pipeline and Storage Contracts. For the avoidance of doubt, the Jackson Prairie Capacity Release Agreement shall not be considered an Interstate Pipeline and Storage Contract for purposes of this Section.

2.5. **Canadian Pipeline Agreements.**

Section 3.8 of the Seller Disclosure Schedule includes those Assigned Contracts that are firm transportation contracts with pipelines located in Canada ("**Canadian Pipelines**") and subject to the

jurisdiction of the National Energy Board ("**Canadian Pipeline Contracts**"), the assignment of which to Purchasers will be subject to the respective tariffs of the Canadian Pipelines and any applicable National Energy Board rules and provincial regulations. Effective as of the Effective Time and subject to the terms of this Agreement, as well as all applicable rules, regulations and tariff provisions of the Canadian Pipelines, Sellers hereby agree to permanently assign, and Purchasers hereby agree to assume, the Canadian Pipeline Contracts, each for its full remaining term and at the maximum rate, except for Canadian Pipeline Contracts that are contracted at a discounted or negotiated rate, which Purchasers agree to assume at the applicable discounted or negotiated rate. Sellers and Purchasers agree to comply with all applicable laws and all applicable provisions and procedures of the Canadian Pipelines' tariffs necessary to enable Purchasers to take direct, permanent assignment of the Canadian Pipeline Contracts. The applicable Purchaser agrees to promptly execute any revised or amended service agreements tendered to it by any of the Canadian Pipelines, each with a term beginning on the Effective Time and continuing through the remaining term of each respective Canadian Pipeline Contract. These revised or amended service agreements will be deemed null and void if this Agreement is terminated pursuant to Section 9, and, if necessary, Purchasers will reassign and Sellers will accept reassignment of the Canadian Pipeline Contracts.

2.6. **Deemed Assignment of Contracts.**

To the extent that the assignment hereunder of any of the Assigned Contracts identified in Section 3.8 of the Seller Disclosure Schedule, other than those Assigned Contracts identified on Schedules 2.2.1(d) and 2.10.16, shall require the consent of any other party (or in the event that any of the same shall be non-assignable), neither this Agreement nor any actions taken hereunder shall constitute an assignment or an agreement to assign if such assignment or attempted assignment would constitute a breach thereof or result in a loss or diminution thereof. Sellers shall cooperate with Purchasers to establish a reasonable arrangement designed to provide Purchasers with the benefits and burdens of any such Assigned Contracts, including to the extent not constituting an assignment or attempted assignment that would violate the foregoing sentence, (a) appointing Purchasers to act as Sellers' agent to perform all of Sellers' obligations under such Assigned Contracts and to collect and promptly remit to Purchasers all compensation received by Sellers pursuant to such Assigned Contracts, (b) Purchasers agreeing to advance on behalf of Sellers, but at the expense of and for the account of Purchasers, amounts due and owing under such Assigned Contracts for obligations pertaining to periods following the Effective Time (including the provision of credit support as may be required by a Counterparty to such Assigned Contracts) and (c) to enforce, at the written request of, at the expense of and for the account and benefit of Purchasers, any and all rights of Sellers against any other person arising out of the breach or cancellation of such Assigned Contracts by such other person or otherwise (any and all of which arrangement shall constitute, as between the Parties, a deemed assignment or transfer); provided that from and after the Effective Time, Sellers shall have no liability to Purchasers in the event that any Assigned Contract requiring consent to assignment hereunder (or which by its terms is non-assignable) is terminated. Purchasers shall reimburse Sellers' for their reasonable costs and expenses (other than Taxes) associated with such alternative arrangements.

2.7. **Canadian Escrow Agent and Canadian Withholding Tax Certificates.**

2.7.1. Delivery of Canadian Withholding Tax Certificate. Subject to this Section 2.7, Avista Energy will deliver to the CRA, with a copy to Purchasers, an application for a Canadian Withholding Tax Certificate in respect of the Purchased Taxable Canadian Property and will take all reasonable steps to obtain and deliver a Canadian Withholding Tax Certificate to Purchasers on or before the Closing Date.

2.7.2. Canadian Withholding. If a Canadian Withholding Tax Certificate specifying a Canadian Withholding Tax Certificate Limit in an amount that is not less than the Taxable Canadian Property Purchase Price is not delivered to Purchasers at or before Closing, Purchasers will withhold from the Purchase Price otherwise payable at Closing the Canadian Withholding Tax Escrow Amount, which amount shall be distributed to the Canadian Withholding Tax Escrow Agent in accordance with the following provisions of this Section 2.7.

2.7.3. Canadian Withholding Tax Payments to CRA. If an amount is withheld under Section 2.7.2 and Avista Energy has received confirmation from CRA that CRA will issue a Canadian Withholding Tax Certificate to Avista Energy if an amount not exceeding the Canadian Withholding Tax Escrow Amount is received by the Receiver General of Canada before the Canadian Withholding Tax Remittance Date, which confirmation has been communicated to Purchasers and is, in form and substance, acceptable to Purchasers, acting reasonably, Purchasers shall notify the Canadian Withholding Tax Escrow Agent of that confirmation, and the Canadian Withholding Tax Escrow Agent will then pay that amount out of the Canadian Withholding Tax Escrow Amount to the Receiver General of Canada solely for purposes of obtaining the Canadian Withholding Tax Certificate and subject to the condition that any part of that amount not so applied and not returned by the Receiver General of Canada to the Canadian Withholding Tax Escrow Agent shall be applied to Purchasers' remittance obligation under subsection 116(5) or (5.3), as applicable of the Canada Tax Act. Purchasers, Avista Energy and the Canadian Withholding Tax Escrow Agent shall cooperate to make reasonable efforts to effect an arrangement with CRA to make the payment described in this Section 2.7.3 and the Canadian Withholding Tax Certificate issuance to occur on a simultaneous basis.

2.7.4. Payments to Sellers. If an amount is withheld under Section 2.7.2 and, before the Canadian Withholding Tax Remittance Date, the Canadian Withholding Tax Escrow Agent receives a Canadian Withholding Tax Certificate in respect of the Purchased Taxable Canadian Property, the Canadian Withholding Tax Escrow Agent will promptly pay to Sellers: (i) the Canadian Withholding Tax Escrow Amount less any part thereof previously paid to the Receiver General of Canada pursuant to Section 2.7.3 if the Canadian Withholding Tax Certificate is issued pursuant to subsection 116(4) of the Canada Tax Act; or (ii) where Section 2.7.4(i) does not apply, the Canadian Withholding Tax Escrow Amount less any part thereof previously paid to the Receiver General of Canada pursuant to Section 2.7.3 and less the product of (A) the amount by which the Taxable Canadian Property Purchase Price exceeds the amount specified in that Canadian Withholding Tax Certificate as the Canadian Withholding Tax Certificate Limit or proceeds of disposition, multiplied by (B) the percentage specified in subsection 116(5) of the Canada Tax Act, if the Canadian Withholding Tax Certificate is issued pursuant to subsection 116(2) of the Canada Tax Act or the percentage specified in subsection 116(5.3) of the Canada Tax Act if the Canadian Withholding Tax Certificate is issued pursuant to subsection 116(5.2) of the Canada Tax Act.

2.7.5. Remittances. If Purchasers have withheld the Canadian Withholding Tax Escrow Amount pursuant to Section 2.7.2 and Sellers do not deliver to Purchasers and the Canadian Withholding Tax Escrow Agent, before the Canadian Withholding Tax Remittance Date, a Canadian Withholding Tax Certificate under subsection 116(2), subsection 116(4), or subsection 116(5.2), as applicable, of the Canada Tax Act specifying a Canadian Withholding Tax Certificate Limit or proceeds of disposition equal to or greater than the Taxable Canadian Property Purchase Price, the Canadian Withholding Tax Escrow Agent will remit to the Receiver General of Canada, on the Canadian Withholding Tax Remittance Date, the Canadian Withholding Tax Amount (less any part thereof previously paid to the Receiver General of Canada on account of such amount pursuant to Section 2.7.3) and the amount so remitted together with any amounts paid pursuant to Section 2.7.3 shall be credited to Purchasers as a Payment on account of the Purchase Price.

2.7.6. Interest. Concurrently with the payments pursuant to Sections 2.7.4 or 2.7.5, if applicable, the Canadian Withholding Tax Escrow Agent will pay to Sellers the interest earned on the Canadian Withholding Tax Escrow Amount while on deposit with the Canadian Withholding Tax Escrow Agent to the date of that payment (less any Tax required to be withheld and remitted).

2.7.7. Confirmations. The Canadian Withholding Tax Escrow Agent will provide Sellers with proof that the Canadian Withholding Tax Escrow Amount and the interest earned thereon while held by the Canadian Withholding Tax Escrow Agent have been disbursed by the Canadian Withholding Tax Escrow Agent in accordance with the provisions of this Section 2.7.

2.7.8. Closing Adjustment. If the Taxable Canadian Property Purchase Price is adjusted pursuant to Section 2.2.2(g), and Purchasers are required to pay to Sellers an additional amount pursuant to Section 2.2.2(g), the foregoing provisions of this Section 2.7 shall apply to that additional amount and in those circumstances and for the purpose of this Agreement, the term "Canadian Withholding Tax Escrow Amount" shall include the applicable withholding rate for the Purchased Taxable Canadian Property times that additional amount, and the term "Canadian Withholding Tax Remittance Date" for such additional amount shall mean the 27th day following the end of the calendar month in which Purchasers are required to pay the additional amount pursuant to Section 2.2.2(g).

2.8. **Allocation of Purchase Price.**

2.8.1. **Allocation of Purchase Price for Tax Purposes.**

Within the later of thirty (30) days following the Closing Date or ten (10) days following the determination of a final Purchase Price, the Parties shall use their commercially reasonable efforts to agree in writing as to the allocation of the Purchase Price among the Acquired Assets. The Parties shall file all tax returns, including IRS Form 8594, in accordance with any such agreed allocation, and shall use their reasonable commercial efforts to sustain any such agreed allocation in any subsequent Tax audit or dispute.

2.8.2. **Allocation in Event of Dispute.**

In the event that the parties are unable to agree upon the allocations provided for under Section 2.8.1, such allocations shall be determined by the Arbitrator, whose determination shall be binding on the parties. Sellers and Purchasers shall each pay one half of the fees and costs of the Arbitrator.

2.9. **Closing.**

The closing of the transactions contemplated by this Agreement shall take place on the Closing Date at the offices of Heller Ehrman LLP in Seattle, Washington or San Diego, California or on such other date and at such other location as the Parties may mutually agree.

2.10. **Deliveries by Sellers.**

On or before the Closing Date and as a condition to closing, Sellers shall deliver to Purchasers the following certificates, instruments and documents, in form and substance reasonably acceptable to Purchasers:

2.10.1. a certificate of an officer of each Seller, in form and substance satisfactory to Purchasers, dated as of the Closing Date, setting forth and attesting to (i) such Seller's authority to enter into this Agreement and the Transaction Agreements and to consummate the transactions contemplated hereby and thereby, and (ii) the incumbency and signature of the officers of such Seller executing this Agreement and the Transaction Agreements and any other documents necessary to consummate the transactions contemplated hereby and thereby;

2.10.2. a certificate, dated as of the Closing Date, executed by the president or a vice-president of each Seller to the effect that each of the conditions specified in Section 7 have been satisfied in all respects;

2.10.3. a copy of the order of the FERC issuing the Jackson Prairie Limited Jurisdiction Certificate;

2.10.4. a copy of the FERC Order Authorizing the Disposition of Jurisdictional Facilities Under Section 203 of the FPA;

2.10.5. an executed copy of the Jackson Prairie Capacity Release Agreement pursuant to which Coral Resources shall be entitled to use not less than 2,976,252 Dths of Jackson Prairie expansion capacity and 104,000 Dths per day of deliverability;

2.10.6. an executed copy of the Lancaster Energy Conversion Agreement;

2.10.7. an executed copy of the Indemnification Agreement;

2.10.8. an executed copy of the Security Agreement and such other documentation as may be required to perfect Purchasers' first priority lien in the collateral as defined therein;

2.10.9. an executed copy of the Escrow Agreement;

2.10.10. an executed copy of the Canadian Withholding Tax Escrow Agreement;

2.10.11. an executed copy of the Guaranty from Avista Capital;

2.10.12. an executed copy of the Agency Agreement;

2.10.13. an executed copy of the NOVA/ANG Capacity Assignment;

2.10.14. an executed copy of the GTN Capacity Release Agreement;

2.10.15. an executed copy of the Transition Services Agreement;

2.10.16. an executed copy of the consents relating to the Assigned Contracts set forth on Schedule 2.10.16;

2.10.17. an executed copy of the consent described on Schedule 2.2.1(d) or, if such consent has not been obtained, written acknowledgement that such consent has not been obtained;

2.10.18. copies of the applications for the Canadian Withholding Tax Certificate pursuant to Section 2.7;

2.10.19. a certification of non-foreign status for Avista Energy, signed by the president or a vice-president of Avista Energy under penalty of perjury, pursuant to Treasury Regulations Section 1.1445-2 dated as of the Closing Date;

2.10.20. complete originals or, if the original is not available, copies, of the Assigned Contracts, with all amendments, transactions, confirmations and correspondence related thereto, shall be available for delivery at Sellers' office(s);

2.10.21. evidence in form and substance satisfactory to Purchasers that all Liens and encumbrances against the Acquired Assets, other than the Permitted Liens and the Assumed Liabilities, have been released or if such release has been delayed solely for administrative reasons, such Liens will be released within two (2) Business Days of the Closing Date;

2.10.22. evidence that Sellers have obtained all consents, authorizations and approvals of all Governmental Authorities and Persons described in Section 5.1.1; and

2.10.23. copies of any Assignments received as of the Closing Date.

2.11. **Deliveries by Purchasers.**

On or before the Closing Date and as a condition to closing, Purchasers shall deliver to Sellers the following certificates, instruments and documents, in form and substance reasonably acceptable to Sellers:

2.11.1. a certificate of an officer of each Purchaser, in form and substance satisfactory to Sellers, dated as of the Closing Date, setting forth and attesting to (i) such Purchaser's authority to enter into this Agreement and the Transaction Agreements and to consummate the transactions contemplated hereby and thereby, and (ii) the incumbency and signature of the officers of such Purchaser executing this Agreement and the Transaction Agreements and any other documents necessary to consummate the transactions contemplated hereby and thereby;

2.11.2. a certificate, dated as of the Closing Date, executed by the president or a vice-president of each Purchaser to the effect that each of the conditions specified in Section 8 have been satisfied in all respects;

2.11.3. an executed copy of the Jackson Prairie Capacity Release Agreement pursuant to which Coral Resources shall be entitled to use not less than 2,976,252 Dths of Jackson Prairie expansion capacity and 104,000 Dths per day of deliverability;

2.11.4. an executed copy of the Lancaster Energy Conversion Agreement;

2.11.5. an executed copy of the Indemnification Agreement;

2.11.6. an executed copy of the Security Agreement and such other documentation as may be required to perfect Purchasers' first priority lien in the collateral as defined therein;

2.11.7. an executed copy of the Escrow Agreement;

2.11.8. an executed copy of the Canadian Withholding Tax Escrow Agreement;

2.11.9. an executed copy of the Agency Agreement;

2.11.10. an executed copy of the NOVA/ANG Capacity Assignment;

2.11.11. an executed copy of the GTN Capacity Release Agreement; and

2.11.12. an executed copy of the Transition Services Agreement.

2.12. **Additional Obligations.**

Subject to the terms and conditions of this Agreement, Avista Energy shall temporarily assign to Coral Power and Coral Power shall accept, Avista Energy's rights, title, interest, and obligations in, to and under the BPA Transmission Agreement. Assignment of the BPA Transmission Agreement shall commence on the Effective Date or at such other date mutually acceptable to Avista Energy and Coral Power and terminate on December 31, 2009. Such assignment shall occur in accordance with the applicable procedures and requirements of the BPA on the date of assignment. During the term of such assignment, Coral Power shall accept and comply with all obligations arising from or under the BPA Tariff associated with the assignment, including the payment of any and all costs related to use of the assigned transmission rights during the term of such temporary assignment. With respect to such assignment, Avista Energy and Coral Power agree in good faith to address any issues related to billing and payment in order to comply with requirements imposed by BPA, as such requirements may be revised from time to time. Provided further and subject to the terms of the Indemnification Agreement, that during the term of such assignment, Purchasers agree to indemnify Avista Energy and hold it harmless from all losses, liabilities or claims including reasonable attorneys' fees and costs of court, from any and all persons, arising from or out of claims of title, personal injury (including death) or property damage from said BPA Transmission Agreement that may have occurred during the term of such temporary assignment. Upon the conclusion of the term of the temporary assignment referred to in this Section 2.12, all rights, title, interest and obligations in, to and under the BPA Transmission Agreement shall revert back to Avista Energy and subject to the terms of the Indemnification Agreement, Avista Energy shall indemnify Purchasers and hold them harmless from all losses, liabilities or claims including reasonable attorneys' fees and costs of court, from any and all persons, arising from or out of claims of title, personal injury (including death) or property damage from said BPA Transmission Agreement that may have occurred during any period of time other than the during the term of the temporary assignment.

2.13. **Further Assurances.**

Subject to the terms and conditions of this Agreement, at any time, or from time to time after the Effective Time, as and when requested by any Party, the other Parties shall promptly execute and deliver, or cause to be executed and delivered, all such documents, instruments and certificates and shall take, or cause to be taken all such further or other actions as are reasonably requested as necessary to evidence and effectuate the transactions contemplated by this Agreement and the Transaction Agreements, in each case at the sole cost and expense of the requesting Party unless the requesting Party is entitled to indemnification therefore under the Indemnification Agreement.

3. **Representations and Warranties of Sellers.**

Sellers hereby, jointly and severally, represent and warrant to Purchasers that the statements contained in this Section 3 are correct and complete as of the date of this Agreement and as of the Effective Time, except as noted herein or as set forth in the disclosure schedule relating to the specified subsection (including by cross-reference contained therein), attached hereto as **Appendix B** (the "**Seller Disclosure Schedule**"). The Seller Disclosure Schedule will be arranged in paragraphs corresponding to the lettered and numbered paragraphs contained in this Section 3 and the other relevant sections of this Agreement.

3.1. **Organization, Standing and Power.**

Avista Energy is a corporation duly organized and validly existing under the Laws of Washington. Avista Canada is an amalgamated corporation duly organized, validly existing and in good standing under the Laws of the Province of Alberta, Canada. Each Seller has all requisite organizational power and authority to enter into this Agreement, to perform its obligations hereunder and to consummate the transactions contemplated hereby. Each Seller is duly qualified or licensed to do business in each other jurisdiction where the actions required to be performed by it hereunder make such qualification or licensing necessary, except in those jurisdictions where the failure to be so qualified or licensed would not reasonably be expected to result in a material adverse effect on such Seller's ability to perform its obligations hereunder.

3.2. **Authority.**

The execution and delivery by each Seller of this Agreement, and the performance by each Seller of its obligations hereunder, have been duly and validly authorized by all necessary action on the part of each Seller and its shareholder(s), as applicable. This Agreement has been duly and validly executed and delivered by each Seller and constitutes the legal, valid and binding obligation of each Seller enforceable against each Seller in accordance with its terms, except as the same may be limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar Laws relating to or affecting the rights of creditors generally, or by general equitable principles.

3.3. **No Conflicts; Consents and Approvals.**

Assuming the filings, approvals, consents, authorizations and notices set forth in Section 3.3 of the Seller Disclosure Schedule or any subpart thereof have been made, obtained or given, the execution and delivery by each Seller of this Agreement, the performance by each Seller of its obligations hereunder, and the consummation of the transactions contemplated hereby will not:

3.3.1. conflict with or result in a violation or breach of any of the terms, conditions or provisions of its Charter Documents;

3.3.2. conflict with, result in a default or violation or breach of any term or provision of any contract other than an Assigned Contract, which is not, individually or in the aggregate, material;

3.3.3. result in the creation of a Lien, other than Permitted Liens, on any of the Acquired Assets;

3.3.4. conflict with, or result in a violation or breach of, any material term or provision of any Law or writ, judgment, order or decree applicable to such Seller or any of its assets; or

3.3.5. require the consent or approval of any Governmental Authority under any applicable Law other than such consents or approvals described in Section 5.1.1.

3.4. **Legal Proceedings.**

No Seller has received written notice of any Claim and, to Sellers' Knowledge, none is threatened against any Seller that (i) seeks to restrain, enjoin or otherwise prohibit or make illegal any of the transactions contemplated by this Agreement or any of the Transaction Agreements or (ii) relates to or arises out of any of the Assigned Contracts. No Seller has received actual notice of the assertion by any Person of a Claim that the consummation of the transactions contemplated hereby would violate any material contract to which any Seller is a party and as to which the claimant could reasonably be expected to assert a Claim against any Purchaser or such Seller with respect to their rights under the Assigned Contracts and, to Sellers' Knowledge, no such Claim has been threatened.

3.5. **Compliance with Laws and Orders.**

No Seller is in violation of or in default under any Law or order applicable to such Seller or its assets the effect of which, individually or in the aggregate, could reasonably be expected to hinder or prevent such Seller from performing its obligations hereunder.

3.6. **Brokers.**

No Seller has any liability or obligation to pay fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement for which Purchasers could become liable or obligated.

3.7. **Title.**

Sellers own and have good and marketable title to the Acquired Assets free and clear of all Liens other than Permitted Liens, Assumed Liabilities and Liens in connection with (i) agreements pursuant to which a Counterparty has imposed a security interest on a Seller's cash margin or marketable securities posted with such Counterparty; (ii) purchase money liens and liens securing rental payments under capital lease arrangements or (iii) the Credit Agreement.

3.8. **Assigned Contracts.**

Section 3.8 of the Seller Disclosure Schedule contains a complete and accurate listing of the Assigned Contracts (excluding confirmation of transactions conducted pursuant to such Assigned Contracts in the ordinary course of business), including all amendments, modifications or waivers thereto, and Sellers have provided to Purchasers true, correct and complete copies of all such Assigned Contracts. Except for any agreement expressly identified as an Excluded Asset, the Assigned Contracts, taken as a whole, constitute substantially all of the operating assets of the Sellers.

3.9. **Enforceability of Assigned Contracts.**

Each of the Assigned Contracts constitutes the legal, valid and binding obligation of each Seller that is a party thereto enforceable against it in accordance with its terms and, to Sellers' Knowledge, constitutes the legal, valid and binding obligation of each other party thereto, except in each case as the same may be limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar Laws relating to or affecting the rights of creditors generally, or by general equitable principles. No Seller has assigned any of its right, title or interest under any Assigned Contract to any other Person except in connection with (i) Permitted Liens, (ii) agreements pursuant to which a Counterparty has

imposed a security interest on a Seller's cash margin or marketable securities posted with such Counterparty; (iii) purchase money liens and liens securing rental payments under capital lease arrangements and (iv) the Credit Agreement.

3.10. **Defaults.**

No Seller is, and to Sellers' Knowledge, no other party is in material breach of or default under any Assigned Contract and no Seller has sent nor received any written notice or, to Sellers' Knowledge, any oral notice, of termination, cancellation, breach or default with respect to any of the Assigned Contracts. To Sellers' Knowledge (i) there are no material disputes between any Seller and any Counterparty under any of the Assigned Contracts and (ii) none of the Assigned Contracts is subject to a declared, continuing event of force majeure.

3.11. **Canadian Agreements.**

To Sellers' Knowledge, Section 3.8 of the Seller Disclosure Schedule identifies any of the Assigned Contracts that, as of April 1, 2007 requires the physical delivery of any Commodity in Canada pursuant to any open transaction or arrangement.

3.12. **Bankruptcy.**

There are no bankruptcy, reorganization or receivership proceedings pending, being contemplated by or, to Sellers' Knowledge, threatened against any Seller. To Sellers' Knowledge, there are no bankruptcy, reorganization or receivership proceedings pending, being contemplated by or threatened against any Counterparty.

3.13. **Claims.**

As of the date of this Agreement:

(a) No Seller has received any written or oral Claim that seeks damages or other monetary relief in connection with any of the Assigned Contracts;

(b) No Seller has received any written or oral Claims that any of the Assigned Contracts are illegal, ineffective or inconsistent with or in violation of any Laws;

(c) No Seller has received any written or oral Claim seeking to modify any term or condition of any of the Assigned Contracts; and

(d) No Seller has received any actual notice of any type or description or in connection with any pending or threatened civil or enforcement Claim by any Governmental Authority against any Seller or any current or former employee, officer, director or agent of any Seller that contends, directly or indirectly, that any of the Assigned Contracts is inconsistent with or in violation of any Laws.

3.14. **Tax Representations.**

All returns, reports, or statements (including any information returns) any Governmental Authority requires to be filed by any Seller for purposes of any Tax ("**Returns**") for which any Seller is liable have been duly and timely filed with the appropriate Governmental Authority having jurisdiction with respect to any Tax ("**Taxing Authority**") and all such Returns are correct and complete. Each Tax shown to be payable on each such Return has been paid. Each Tax payable by any Seller by assessment has been timely paid in the amount assessed. No Seller is, or has ever been, liable for any Tax payable by reason of the income or property of a Person other than such Seller. Each Seller has timely filed true, correct and complete declarations of estimated Tax in each jurisdiction in which any such declaration is required to be filed by it. No Liens for Taxes exist upon any of the Acquired Assets except Liens for Taxes that are not yet due. No Claim with respect to any Tax for which any Seller is asserted to be liable

is pending or, to Sellers' Knowledge, threatened and no basis that any Seller believes to be valid exists on which any Claim for any such Tax can be asserted against any Seller or any of the Acquired Assets. There are no requests for rulings or determinations in respect of any Taxes pending between a Seller and any Taxing Authority. No currently effective extension of any period during which any Tax may be assessed or collected and for which any Seller is or may be liable has been granted to any Taxing Authority. All amounts required to be withheld by any Seller and paid to governmental agencies for income, social security, unemployment insurance, sales, excise, use, value added and other Taxes have been collected or withheld and paid to the proper Taxing Authority. Each Seller has made all deposits required by Law to be made with respect to employees' withholding and other employment Taxes.

3.15. **Canadian Tax Representation.**

Avista Canada is duly registered under Part IX of the *Excise Tax Act* (Canada) with respect to the goods and services tax and harmonized sales tax and its registration number is 87626 4367 RT0001.

3.16. **Credit Support; Pre-Paid Deposits.**

3.16.1. With respect to guaranties, letters of credit, comfort letters, surety bonds, cash and other credit support in favor of any Counterparty provided by or on behalf of any Seller or its Affiliates in support of the obligations of such Seller or Affiliate (together, the "**Credit Support**"), Section 3.16.1 of the Seller Disclosure Schedule contains a complete and accurate list and summary description of all Credit Support as of March 31, 2007. Sellers have not defaulted or otherwise created a circumstance that triggers the right of any party to make a Claim under the Credit Support and there are no pending disputes with respect to any Credit Support.

3.16.2. With respect to pre-paid obligations, pre-paid cash deposits or deposits of marketable securities in favor of any Counterparty provided by a Seller or its Affiliates in support of the obligations of such Seller (together, the "**Pre-Paid Deposits**"), Section 3.16.2 of the Seller Disclosure Schedule contains a complete and accurate list and summary description of all Pre-Paid Deposits as of March 31, 2007. Sellers have not defaulted or otherwise created a circumstance that triggers the right of any party to make a Claim against or otherwise seize all or any portion of the Pre-Paid Deposits and there are no pending disputes with respect to any Pre-Paid Deposits.

3.16.3. With respect to guaranties, letters of credit, comfort letters, surety bonds, cash and other credit support in favor of a Seller provided by or on behalf of any of any Counterparty or its affiliates in support of the obligations of such Counterparties (together, the "**Counterparty Credit Support**"), Section 3.16.3 of the Seller Disclosure Schedule contains a complete and accurate list and summary description of all Counterparty Credit Support as of March 31, 2007. No counterparty is in default or has otherwise created a circumstance that triggers the right of a Seller to make a Claim under the Counterparty Credit Support and there are no pending disputes with respect to any Counterparty Credit Support.

3.16.4. With respect to pre-paid obligations, pre-paid cash deposits or deposits of marketable securities on behalf of the Counterparties deposited with Sellers in support of the obligations of the Counterparties under the Assigned Contracts (together, the "**Counterparty Pre-Paid Deposits**"), Section 3.16.4 of the Seller Disclosure Schedule contains a complete and accurate list and summary description of all Counterparty Pre-Paid Deposits as of March 31, 2007. Neither Seller has alleged or claimed a circumstance that triggers the right of any party to make a Claim against or otherwise seize all or any portion of the Counterparty Pre-Paid Deposits nor are there any pending disputes with respect to any Counterparty Pre-Paid Deposits.

3.17. **Environmental, Health and Safety.**

3.17.1. To Sellers' Knowledge, there is no reasonable basis for a Claim alleging injury arising out of or related to exposure to Commodities or any other substances (i) present at Sellers' facilities or (ii) owned, transported, leased or brokered by either of the Sellers.

3.17.2. Neither Seller has any liability and, to Sellers' Knowledge, neither of the Sellers (or their respective predecessors, if any) has handled or disposed of any substance, arranged for the disposal of any substance, exposed any employee or other individual to any substance or condition or owned or operated any property or facility in any manner that could form a reasonable basis for any present or future Claim against either of the Sellers giving rise to any liability for damage to any site, location, or body of water (surface or subsurface), for any illness of or personal injury to any employee or other individual, or for any reason under any Law. Neither of the Sellers has received any written communication, whether from a Governmental Authority, citizens group, employee or otherwise, that alleges a Seller is not in compliance with applicable environmental Laws.

3.18. **Commodities.**

3.18.1. Valuation Policy. Subject to amounts reserved for Commodities, the values at which all Commodities and Commodities Transactions are carried in Sellers' financial statements reflect the historical valuation policy of the Sellers and the Commodity Valuation Methodology. Sellers have title or rights to the Commodities, transmission and transportation agreements sufficient to operate the business in all material respects as it is presently conducted.

3.18.2. Trade Confirmations. Sellers' binding trade confirmations (whether written or oral) under each of the applicable Assigned Contracts are promptly and properly recorded in the Trade Book.

3.18.3. Risk and Credit Policy. Sellers have at all times during calendar year 2006 and through the date of this Agreement been in material compliance with the requirements of the Risk Policy and Credit Policy. Sellers have established reserves for the risks of their trading activities in accordance with GAAP and the amount of such reserves are reflected in the Net Trade Book Value as of the applicable date of calculation.

3.19. **Employees.**

3.19.1. Section 3.19.1 of the Seller Disclosure Schedule contains a complete and accurate list of the following information for each employee of Sellers, including each employee on leave of absence or layoff status: Employer; name; job title; part-time or full time status, current compensation paid or payable and any change in compensation since January 1, 2007; and service credited for purposes of vesting and eligibility to participate under any Employee Benefit Plan or any Employee Arrangement.

3.19.2. Sellers have paid in full to, or accrued on behalf of, all Persons performing services for Sellers as required by Law, all payments, wages, salaries, commissions, bonuses and other direct compensation for all services performed by such Persons, all vacation and other benefits that have accrued through the date of this Agreement for such Persons, and all amounts required to be reimbursed to such Persons for which appropriate reimbursement requests have been submitted or, to Sellers' Knowledge, are expected to be submitted.

3.19.3. There is no labor strike, dispute, slowdown, work stoppage or lockout actually pending or, to Sellers' Knowledge, threatened against or affecting Sellers.

3.19.4. Sellers are not parties to or bound by any collective bargaining or similar agreement with any labor organization, or work rules or practices agreed to with any labor organization or employee association applicable to employees of Sellers.

3.19.5. None of the employees of the Sellers are represented by any labor organization and, to Sellers' Knowledge, there are no current union organizing activities among the employees of Sellers, nor does any question concerning representation exist concerning such employees.

3.19.6. Avista Canada's workers' compensation account and source deductions are in good standing.

3.19.7. No charges of discrimination or other violation of equal employment laws with respect to or relating to Sellers are pending or, to Sellers' Knowledge, threatened before the Equal Employment Opportunity Commission or any other Governmental Authority. Sellers have not engaged in any unfair labor practice and no unfair labor practice complaint, grievance or arbitration proceeding is pending, or to Sellers' Knowledge, threatened.

3.19.8. To Sellers' Knowledge, no Governmental Authority responsible for the enforcement of labor or employment Laws intends to conduct an investigation or compliance audit with respect to or relating to Sellers labor or employment practices and no such investigation or compliance audit by any Governmental Authority is in progress.

3.19.9. There are no pending or, to Sellers' Knowledge, threatened wage and hour claims filed against Sellers with the United States Department of Labor or any other Governmental Authority.

3.19.10. There are no pending citations relating to Sellers filed by the Occupational Safety and Health Administration nor any other Governmental Authority and there are, to Sellers' Knowledge, no such threatened citations relating to Sellers.

3.20. **Employment Benefit Matters.**

3.20.1. Section 3.20.1 of the Seller Disclosure Schedule lists each Seller Employee Benefit Plan and each Seller Employee Arrangement, and such Schedule includes each Employee Benefit Plan or Employee Arrangement that is sponsored, maintained, or contributed to by an Affiliate of Sellers that covers or benefits employees of Sellers. Section 3.20.1 of the Seller Disclosure Schedule separately identifies each Seller Employee Benefit Plan and Seller Employee Arrangement that provides for any payment (whether of severance pay or otherwise) or acceleration, vesting or increase in benefits with respect to any employee, director or consultant of any of the Sellers upon the occurrence of a change in control or a severance or termination of service (either alone or upon the occurrence of any additional or subsequent events).

3.20.2. Sellers have delivered to Purchasers correct and complete copies of the plan documents and summary plan descriptions for each Seller Employee Benefit Plan and Seller Employee Arrangement that covers or benefits employees of the Sellers.

3.20.3. Except as set forth in Section 3.20.3 of the Seller Disclosure Schedule or in the next following sentence, as to any Seller Employee Pension Benefit Plan that is subject to Title IV of ERISA, there has been no event or condition which presents the risk of Employee Pension Benefit Plan termination, no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the Code has been incurred, no reportable event within the meaning of Section 4043 of ERISA (for which the disclosure requirements have not been waived) has occurred, no notice of intent to terminate such Employee Pension Benefit Plan has been given under Section 4041 of ERISA, no proceeding has been instituted under Section 4042 of ERISA to terminate such Employee Pension Benefit Plan, no liability to the PBGC has been incurred, and the assets of such Employee Pension Benefit Plan equal or exceed the actuarial present value of the benefit liabilities, within the meaning of Section 4041 of ERISA, under such Employee Pension Benefit Plan, based upon reasonable actuarial assumptions and the asset valuation principles established by the PBGC. As of December 31, 2006, the assets of the Retirement Plan for Employees of Avista Corporation do not equal or exceed the actuarial present value of the benefit liabilities, within the meaning of Section 4041 of ERISA, under such

plan, based upon reasonable actuarial assumptions and the asset valuation principles established by the PBGC. As of December 31, 2006, the funded status of such plan on this basis expressed as a percentage has not materially decreased, and such benefit liabilities have not materially increased, since Sellers' disclosure regarding the plan on September 30, 2006.

3.20.4. With respect to any Employee Pension Benefit Plan which is not listed in Section 3.20.1 of the Seller Disclosure Schedule but which is sponsored, maintained or contributed to, or has been sponsored, maintained or contributed to within six years prior to the Closing Date, by any corporation, trade, business or entity under common control with the Sellers, within the meaning of Section 414(b), (c) or (m) of the Code or Section 4001 of ERISA ("**Commonly Controlled Entity**"), (A) no withdrawal liability, within the meaning of Section 4201 of ERISA, has been incurred, which withdrawal liability has not been satisfied, (B) no liability to the PBGC has been incurred by any Commonly Controlled Entity, which liability has not been satisfied, (C) no accumulated funding deficiency, whether or not waived, within the meaning of Section 302 of ERISA or Section 412 of the Code has been incurred, and (D) all contributions (including installments) to such plan required by Section 302 of ERISA and Section 412 of the Code have been timely made.

3.21. **No Material Change in Conduct.**

Since October 31, 2006, there has not been:

3.21.1. any change in the business, operations, properties or assets, liabilities, condition (financial or other) or results of operations of the Sellers that could reasonably be expected, either alone or together with all other such changes, to have a material adverse effect on the Acquired Assets;

3.21.2. any creation or other incurrence of any Lien (other than Permitted Liens or in connection with (i) agreements pursuant to which a Counterparty has imposed a security interest on a Seller's cash margin or marketable securities posted with such Counterparty; (ii) purchase money liens and liens securing rental payments under capital lease arrangements or (iii) the Credit Agreement) on any Acquired Asset;

3.21.3. any damage, destruction or other casualty loss (whether or not covered by insurance) affecting the Acquired Assets which, individually or in the aggregate, has had or could reasonably be expected to have a material adverse effect on the Acquired Assets;

3.21.4. any transaction or commitment made, or any contract or agreement entered into, by either of the Sellers (including the acquisition or disposition of any assets) or any relinquishment by any Seller of any contract or other right, in either case, material to Acquired Assets, other than transactions and commitments in the ordinary course of business consistent with past practices and those contemplated by this Agreement;

3.21.5. any change in any method of accounting or accounting practice, reserve methodology and associated assumptions by Sellers with respect to accounting for the Acquired Assets and Assumed Liabilities except for any such change adopted in accordance with GAAP;

3.21.6. any (i) employment, deferred compensation, severance, retirement or other similar agreement entered into with any employee of the Sellers (or any amendment to any such existing agreement), (ii) grant of any severance or termination pay to any such employee or (iii) change in compensation or other benefits payable to any such employee pursuant to any severance or retirement plans or policies; or

3.21.7. any labor dispute, other than routine individual grievances, or any activity or proceeding by a labor union or representative thereof to organize any employees of the Sellers, or any lockouts, strikes, slowdowns, work stoppages or threats thereof by or with respect to such employees.

3.22. **Investment Company Act.**

Neither Seller is an "investment company" within the meaning of the Investment Company Act of 1940 as amended.

3.23. **Investment Canada Act Compliance.**

For the purposes of Sections 14 and 14.1 of the Investment Canada Act, the value of the assets of the Canadian business or businesses to be acquired under this Agreement and the Transaction Agreements does not exceed Canadian $281 million.

4. **Representations and Warranties of Purchasers.**

Except as otherwise noted herein, Purchasers hereby, jointly and severally, represent and warrant to Sellers that the statements contained in this Section 4 are correct and complete as of the date of this Agreement and as of the Effective Time.

4.1. **Organization, Standing and Power.**

Coral Holding and Coral Resources are limited partnerships duly organized, validly existing and in good standing under the Laws of Delaware, Coral Power is a Delaware limited liability company, duly organized, validly existing and in good standing under the Laws of Delaware and Coral Canada is a corporation duly organized, validly existing and in good standing under the Laws of the Province of Alberta, Canada. Coral Holding and Coral Resources each have all requisite partnership power and authority to enter into this Agreement, to perform their obligations hereunder and to consummate the transactions contemplated hereby. Coral Power and Coral Canada each have all requisite organizational power and authority to enter into this Agreement, to perform their obligations hereunder and to consummate the transactions contemplated hereby. Each Purchaser is duly qualified or licensed to do business in each other jurisdiction where the actions required to be performed by it hereunder make such qualification or licensing necessary, except in those jurisdictions where the failure to be so qualified or licensed would not reasonably be expected to result in a material adverse effect on such Purchaser's ability to perform its obligations hereunder.

4.2. **Authority.**

The execution and delivery by each Purchaser of this Agreement and the performance by each Purchaser of its obligations hereunder have been duly and validly authorized by all necessary action on the part of each Purchaser and its shareholder(s) or partners, as applicable. This Agreement has been duly and validly executed and delivered by each Purchaser and constitutes the legal, valid and binding obligation of each Purchaser enforceable against each Purchaser in accordance with its terms except as the same may be limited by bankruptcy, insolvency, reorganization, arrangement, moratorium or other similar Laws relating to or affecting the rights of creditors generally.

4.3. **No Conflicts.**

The execution and delivery by each Purchaser of this Agreement, the performance by each Purchaser of its obligations hereunder and the consummation of the transactions contemplated hereby will not:

(a) conflict with or result in a violation or breach of any of the terms, conditions or provisions of its Charter Documents;

(b) conflict with, result in a default or violation or breach of any term or provision of any contract which is not, individually or in the aggregate, material;

(c) conflict with, or result in a violation or breach of, any material term or provision of any Law or writ, judgment, order or decree applicable to such Purchaser or any of its assets; or

(d) require the consent or approval of any Governmental Authority under any applicable Law other than such consents or approvals described in Section 5.1.1.

4.4. **Legal Proceedings.**

No Purchaser has been served with notice of any Claim, and to Purchasers' Knowledge none is threatened against any Purchaser that seeks to restrain, enjoin or otherwise prohibit or make illegal any of the transactions contemplated by this Agreement or any of the Transaction Agreements.

4.5. **Compliance with Laws and Orders.**

No Purchaser is in violation of or in default under any Law or order applicable to such Purchaser or its assets the effect of which, individually or in the aggregate, could reasonably be expected to hinder or prevent such Purchaser from performing its obligations hereunder.

4.6. **No Brokers.**

No Purchaser has any liability or obligation to pay fees or commissions to any broker, finder or agent with respect to the transactions contemplated by this Agreement for which any Seller could become liable or obligated.

4.7. **Canadian Tax Representation.**

Coral Canada is duly registered under Part IX of the Excise Tax Act (Canada) with respect to the goods and services tax and harmonized sales tax and its registration number is: 89081 5491 RT0001.

5. **Pre-Closing Covenants**

The Parties hereby covenant and agree as follows for all periods prior to the Effective Time:

5.1. **Regulatory and other Authorizations**

5.1.1. Each of the Parties will give any notices to, make any filings with, and use its commercially reasonable efforts to obtain any authorizations, consents and approvals of Governmental Authorities and non-governmental third parties required or necessary to consummate the transactions contemplated herein or in the Transaction Agreements. Without limiting the generality of the foregoing:

(a) Each of the Parties will promptly file any Notification and Report Forms and related material that may be required with the Federal Trade Commission ("**FTC**") and the Antitrust Division of the United States Department of Justice ("**DOJ**") under the Hart-Scott-Rodino Act if any Party reasonably concludes such filing is necessary or advisable. In connection with any such filing, each Seller and each Purchaser shall furnish to the other such information and assistance as the other may reasonably request in connection with its preparation of any filing or submission necessary under the Hart-Scott-Rodino Act. The Parties shall keep each other apprised in a prompt manner of the status and inquiries or request for additional information from the FTC and the DOJ and shall comply promptly with any such inquiry request. The Parties shall use commercially reasonable efforts to obtain the early termination or expiration of any applicable waiting period required under the Hart-Scott-Rodino Act for the consummation of the transactions contemplated hereby. Purchasers shall pay one-half of any fee for any filing or submission necessary under the Hart-Scott-Rodino Act and Sellers shall pay the remaining one-half of any such fee.

(b) Sellers shall make an appropriate filing, pursuant to Section 203 of the FPA and any applicable state law or regulation with respect to the transactions contemplated by the

Transaction Agreements and to supply as promptly as practicable to the appropriate Governmental Authorities any additional information and documentary material that may be requested by a Governmental Authority. With respect to any such filings, including filings that will be submitted pursuant to the FPA, the Parties shall cooperate with respect to information necessary for such filings and shall give each other reasonable opportunity to comment on and revise drafts of any such filings before such filings are submitted to the appropriate Governmental Authority. Sellers shall refrain from taking any action that causes Sellers to be regulated by or under any Governmental Authority. Purchasers shall pay one-half of any fee for any filing or submission necessary under the FPA and Sellers shall pay one-half of any such fee. Except as expressly provided in this Agreement, each Party shall bear the costs associated with any other authorizations, notifications and consents for which it is responsible under this Agreement.

(c) Each of the Parties as appropriate will make any filing that is required or advisable in order to obtain prompt Competition Act Approval if any Party reasonably concludes such filing is necessary or advisable. In connection with any such filing, each of the Parties shall use commercially reasonable efforts to obtain Competition Act Approval as promptly as possible. Purchasers shall approve all filings and other written communications to the Commissioner, and Purchasers shall have the right to be present at any meetings (whether via telephone, in person or otherwise) involving Sellers and the Commissioner or other Competition Bureau personnel. Sellers shall furnish to Purchasers such information and assistance as Purchasers may reasonably request in connection with the preparation of any filing or submission necessary or advisable in connection with obtaining Competition Act Approval. Sellers shall keep Purchasers apprised in a prompt manner of any inquiries or request for additional information from the Commissioner and, subject to this Agreement, shall comply promptly with any such inquiry request. Purchasers shall keep Sellers reasonably informed as to the status of the proceedings related to obtaining the Competition Act Approval, including providing Sellers with copies of all written communications, in draft form, in order for Sellers to provide their reasonable comments. If any information to be shared between the Parties pursuant to this paragraph is deemed to be confidential information as determined reasonably by the disclosing Party, such information will be shared only with outside counsel of the other Parties. Purchasers shall pay one-half of any fee required under the Competition Act and Sellers shall pay the remaining one-half of such fee.

5.1.2. In order to consummate the transactions contemplated hereby, from the date hereof until the Effective Time, Sellers and Purchasers will work cooperatively and in good faith to take all commercially reasonable steps necessary or desirable, to obtain as promptly as practicable Assignments executed by each of the Counterparties to the Assigned Contracts listed in Section 3.8 of the Seller Disclosure Schedule.

5.2. **Certain Restrictions.**

Except as permitted or contemplated hereby or by the Transaction Agreements, from the date hereof until the Effective Time, each of the Sellers will conduct its business in the ordinary course of business consistent with past practice and use its commercially reasonable efforts to (i) preserve and maintain intact its business organizations and its business, (ii) keep available the services of its employees, (iii) continue in full force and effect without material modification the same or appropriate substitute policies or binders of insurance currently maintained in respect of its business and (iv) preserve its current relationships with Persons with which it has significant business relationships so long as such business relationships continue to satisfy the Risk Policy and the Credit Policy. Without limiting the foregoing, except as permitted or contemplated hereby or by the Transaction Agreements, no Seller will, without first obtaining the prior written consent of a Purchaser:

5.2.1. acquire, sell, lease, transfer, or otherwise dispose of, directly or indirectly, any Tangible Asset except in the ordinary course of business consistent with past practice;

5.2.2. agree or consent to any new agreement which would be accounted for as a Manually Recorded Commodity Transaction due to the inability of the Nucleus software system to accurately value such transaction, except for any item related to valuation adjustments required to comply with GAAP, Commodity Transactions that would not physically encumber any Fixed Transaction and any Commodity Transaction that is capable of being consummated in the brokered gas or power markets;

5.2.3. for the agreements that are or will be part of the Assigned Contracts, agree or consent to any new agreement or material modifications of an existing agreement *other than*: (i) agreements identified on Schedule 5.2.3(i); (ii) agreements having a term equal to or less than one year and involving aggregate monetary obligations equal to or less than $1,000,000 other than any Commodity Transaction entered into in the ordinary course of business; (iii) the entry into any agreement that provides a framework for a trading relationship between any Seller and a Counterparty, including agreements generally known in the Commodity Transactions Business as master agreements, enabling agreements, interchange agreements, netting agreements and Commodity Service Agreements and transactions under any such agreement in the ordinary course of business; (iv) the entry into new or renewal of transportation, transmission or storage agreements having a term expiring before October 31, 2007; (v) the termination of agreements identified on Schedule 5.2.3(v).

5.2.4. mortgage or pledge an Acquired Asset, or create or suffer to exist any Lien, other than Permitted Liens and Liens in connection with (i) agreements pursuant to which a Counterparty has imposed a security interest on a Seller's cash margin or marketable securities posted with such Counterparty; (ii) purchase money liens and liens securing rental payments under capital lease arrangements or (iii) the Credit Agreement, thereupon;

5.2.5. terminate, amend, modify or change in any respect an Assigned Contract other than amendments, modifications or changes that will be effective only for periods prior to the Effective Time and will not have any effect on any Assigned Contract on or after the Effective Time and modifications permitted pursuant to Section 5.2.3;

5.2.6. unless mutually agreed otherwise or permitted pursuant to Section 5.2.3, grant any waiver of any term under or give any consent with respect to any Assigned Contract;

5.2.7. settle or resolve any pending or threatened Claim or investigation concerning the Assigned Contracts, unless such settlement or resolution creates no current or future obligation on any Purchaser, creates no encumbrance on the rights under an Assigned Contract to be acquired by Purchasers and does not alter the economic terms of any of the Assigned Contracts with respect to any period after the Effective Time;

5.2.8. adopt a plan of complete or partial liquidation or resolutions providing for or authorizing a liquidation, dissolution, purchase, consolidation, restructuring, recapitalization or other reorganization which would become effective prior to the Effective Date or could otherwise affect or impair the transactions contemplated hereunder or in the Transaction Agreement;

5.2.9. transfer the work location of employees, hire any new employees, or enter into, modify or amend any employee or director employment contracts, compensation arrangements or benefits unless required by applicable Law or as otherwise agreed by the Parties; or

5.2.10. commit to do any of the foregoing.

In the event that Sellers decide to enter into a new transportation, transmission or storage agreement having a term expiring after April 30, 2007 and on or before October 31, 2007, it shall first provide Purchasers an opportunity to provide such transportation, transmission or storage at a price or prices and on terms and conditions substantially the same as those that such Seller is able to obtain from a third party. If Purchasers do not elect to accept this opportunity within 48 hours of the time offered, then Sellers may enter into the agreement with the third party.

5.3. **Sellers' Operations.**

Except as permitted or contemplated by the Transaction Agreements, from the date hereof until the Effective Time, Sellers agree that they will:

5.3.1. Use commercially reasonable efforts to (i) preserve and maintain intact their business organizations and business, (ii) keep available to Sellers the services of their employees, (iii) preserve their current relationships with Persons with which they have significant business relationships so long as such business relationships continue to satisfy their Risk and Credit Policies, and (iv) maintain the services provided by their Affiliates on terms consistent with past practices.

5.3.2. For each month from the date of this Agreement through the Closing Date, Sellers shall, in good faith, obtain or prepare and send to Purchasers the financial records and reports as specified in Schedule 5.3.2. All valuation adjustments shall be made on the same basis and pursuant to the same principles, methodologies and procedures as were used by Sellers in preparing their financial statements and shall be consistent with and reflect the valuation methodology described in the Risk Policy and other methods, standards, policies and procedures described in, and using the same assumptions and gross reserves contained in, the electronic mark-to-market commodity valuation methodology files, complete and accurate copies of which are contained in the folder labeled "mark-to-market commodity valuation methodology folder" in the Data Room (the "**Commodity Valuation Methodology**").

5.3.3. Sellers shall maintain in Jackson Prairie and the Montana Natural Gas Facility at least the minimum amount of working natural gas required pursuant to any agreement or tariff to ensure that from and after the Effective Time, Purchasers shall have the right to utilize the full capacity, including injection and withdrawal rights, of such storage facilities allocable to them pursuant to the terms of the applicable Assigned Contracts and Jackson Prairie Capacity Release Agreement without penalty or diminution as a result of a failure to maintain at least such minimum amount of working natural gas.

5.4. **Access to Information.**

Prior to the Effective Time, Sellers shall cooperate and make available to each Purchaser and its Representatives, upon reasonable notice and during normal business hours, (i) all books, records and information of Sellers relating to the Acquired Assets, (ii) such appropriate officers and employees of Sellers as requested by Purchasers, and (iii) such other information concerning the Acquired Assets as Purchasers and such Representatives may reasonably request.

5.5. **Updates to Information.**

From the date hereof until the Effective Time, Sellers and Purchasers shall give each other prompt written notice of any development that could reasonably be expected to result in a failure of a condition to Sellers' or Purchasers' obligations set forth in Sections 3, 4, 7 and 8.

5.6. **Data Room Preservation.**

Except as otherwise agreed by the Parties, Sellers shall prepare and promptly deliver to Purchasers one or more DVD discs containing complete and accurate copies of all materials in the Data Room as of five (5) Business Days prior to the Closing Date. Within ten (10) days following the Closing Date, Sellers shall deliver to Purchasers a DVD disc containing any updates to the Data Room between the aforementioned date and the Closing Date.

5.7. **No Change in Accounting Methodologies; Credit Policy or Risk Policy.**

Sellers shall not make any changes to their financial accounting methods, except as required by Law or by GAAP to the extent failure to adopt such changes would cause such financial accounting methods not to be in accordance with GAAP with the concurrence of its independent accountants and after notice to Purchasers, or Risk Policy from the date hereof through the Effective Time. Sellers shall conduct their operations in material compliance with its Credit Policy and Risk Policy as applied on a consistent basis and in accordance with past practice.

5.8. **Exclusivity.**

From the date hereof through the Effective Time, Sellers will not (and Sellers will not cause or permit any of their Affiliates, and their respective officers, directors, representatives or agents to) solicit, initiate or encourage the submission of any proposal or offer from any Person relating to the acquisition of any capital stock or other voting securities, or any of the Acquired Assets (other than Commodities and Tangible Assets sold in the ordinary course of business) of, either of the Sellers, including any acquisition structured as a purchase, consolidation, exchange of membership interests, or share exchange.

5.9. **Data Privacy.**

5.9.1. None of the Purchasers shall use the Disclosed Personal Information for any purposes other than those related to the performance of this Agreement and the completion of the transactions contemplated hereunder.

5.9.2. Purchasers and Sellers acknowledge and confirm that the disclosure of Personal Information is necessary for the purposes of determining if the Parties shall proceed with the transactions contemplated hereunder, and that the disclosure of Personal Information relates solely to the carrying of the operations in Canada or the completion of the transactions contemplated hereunder.

5.9.3. Purchasers shall at all times keep strictly confidential all Disclosed Personal Information, and shall instruct those employees responsible for processing such Disclosed Personal Information to protect the confidentiality of that information in a manner consistent with Purchasers' obligations hereunder. Purchasers shall ensure that access to the Disclosed Personal Information shall be restricted to those employees or service providers of Purchasers who have a *bona fide* need to access that information.

5.9.4. Coral Canada undertakes, after the Closing Date, to utilize the Disclosed Personal Information only for the purposes for which the Disclosed Personal Information was initially collected.

5.9.5. If the closing of the transactions contemplated herein does not occur, Purchasers shall immediately cease to use all of the Disclosed Personal Information and will destroy in a secure manner, the Disclosed Personal Information (and any copies thereof, provided, however, that automatic computer back-up tapes may be permitted to expire in accordance with normal procedures) and shall provide Sellers with a certificate of a senior officer of each Purchaser confirming that destruction.

5.10. **Release of Credit Support.**

5.10.1. Prior to the Closing Date:

(a) Purchasers agree to exercise commercially reasonable efforts necessary or desirable in order to permit all Credit Support relating solely to Sellers' obligations under the Assigned Contracts, including those provided by either or both of Avista Corporation and Avista Capital, to be terminated and released, contingent upon consummation of the transactions contemplated herein and effective as of the Effective Time upon terms and conditions currently in place with such Counterparties. In the event that Purchasers are unable to replace any such Credit Support prior to the Closing Date, Purchasers, Sellers and Avista Capital shall enter into an indemnification or reimbursement agreement whereby any such Credit Support obligations shall be assumed by Purchasers. Purchasers and Sellers shall cooperate with each other in seeking BNP Paribas' consent to the substitution of one or more Purchasers for one or more Sellers under such Seller's or Sellers' outstanding letters of credit pursuant to a reimbursement or other similar arrangement.

(b) Purchasers and Sellers agree to exercise commercially reasonable efforts to transfer any rights to Pre-Paid Deposits to Purchasers.

(c) Purchasers and Sellers agree to exercise commercially reasonable efforts necessary or desirable in order to permit the assignment of their rights under any Counterparty Credit Support to Purchasers.

(d) Purchasers and Sellers agree to exercise commercially reasonable efforts to transfer any rights to Counterparty Pre-Paid Deposits to Purchasers.

Each such assignment or transfer shall be contingent upon consummation of the transactions contemplated herein and effective as of the Effective Time.

5.10.2. Following the Closing Date, Sellers and Purchasers shall continue to exercise commercially reasonable efforts, in conjunction with Counterparties as necessary or appropriate, to have all remaining Pre-Paid Deposits and Counterparty Pre-Paid Deposits assigned, transferred, repaid, substituted for alternative credit or otherwise eliminated. On or before seven (7) Business Days after the Effective Time, a payment, if required, shall be made to settle any remaining Pre-Paid Deposits and Counterparty Pre-Paid Deposits equal to the total amount of remaining Pre-Paid Deposits minus the total amount of remaining Counterparty Pre-Paid deposits. If this difference is a positive number, the amount of the difference shall be paid by Purchasers to Sellers. If the difference is a negative number, the amount of the difference shall be paid by Sellers to Purchasers.

## 6. **Post-Closing Covenants**

From the date hereof through the time frames specified herein, the Parties covenant and agree as follows:

### 6.1. **Transitional Services.**

The Parties each recognize that certain post-closing transitional services will be needed by Purchasers from Sellers and their Affiliates and that Sellers may need some post-closing transitional services from Purchasers. The Parties agree to cooperate and work together in good faith to provide the necessary transitional services to each other, provided such service requirements do not last beyond a period of six months unless extended by mutual agreement of the Parties, upon terms and conditions reasonably satisfactory to each Party. Each Party acknowledges that it is the intent that such services will be provided to each other at their approximate cost and may include services currently received by Sellers from their Affiliates.

### 6.2. **Customer Inquiries; Referrals.**

Neither Seller shall take any action that is designed or intended to have the effect of discouraging any lessor, licensor, customer, supplier or other business associate of such Seller from maintaining the same business relationships with Purchasers, as applicable, after the Closing Date as it maintained with such Seller prior to the Closing Date. Sellers will refer all customer inquiries relating to the Acquired Assets to Purchasers from and after the Closing Date. For one year after the Closing Date:

6.2.1. Sellers shall amend their web site(s) to redirect any person looking for information and/or contacts related to the Acquired Assets or Assumed Liabilities to such web site(s) designated by Purchasers, and

6.2.2. Sellers shall redirect incoming e-mail addressed to any Person previously employed or who otherwise was under contract with Sellers who is, as of the Effective Time, employed or otherwise under contract with Purchasers, including any independent contractors, to such account or accounts designated by Purchasers.

6.3. **Use of Name.**

Purchasers acknowledge that Purchasers shall not have any rights to the name "Avista". Purchasers and Sellers shall be entitled to refer to Purchasers, as the purchasers of substantially all of Avista Energy's former marketing and trading business. In the event that the provisions of Section 2.6 apply, Purchasers shall be entitled to refer to themselves as Avista Energy's or Avista Canada's (as applicable) authorized agent or representative.

6.4. **Confidential Information.**

6.4.1. Except as set forth below, for two years from and after the Closing Date, with respect to any and all information, matters or things of a confidential or proprietary nature concerning the Acquired Assets or the Assumed Liabilities, and not generally known or available to the public, Sellers and their Representatives shall keep any such data or information in confidence. Except as set forth below, for two years from and after the Closing Date, with respect to any and all information, matters or things of a confidential or proprietary nature concerning the Excluded Assets or the Retained Liabilities, and not generally known or available to the public, Purchasers and their Representatives shall keep any such data or information in confidence. Unless otherwise expressly provided in this Agreement, the terms and conditions of any other confidentiality agreement by which any Person may be bound shall not be modified or reduced by this Section 6.4.

6.4.2. With respect to the obligations under this Section 6.4, in the event a Party is requested or required (by oral question or request for information or documents in any legal proceeding, interrogatory, subpoena, civil investigative demand or similar process by a Governmental Authority or other Person, including disclosure to state or federal regulatory authorities, disclosure pursuant to the rules of the Securities and Exchange Commission or any national securities exchange on which a Party or its Affiliate's securities may be traded or to ratings agencies), to disclose any such information, such Party shall use commercially reasonable efforts to notify the other Parties promptly of such request or requirement and provide the other Parties with an opportunity to resist such request or requirement.

6.4.3. The obligations of restricted use and strict confidentiality set forth herein shall not extend to any information which: (i) is legally in the possession of a Party independent of the transactions contemplated hereunder prior to the Effective Time; (ii) is independently developed by a Party or its employees, consultants, Affiliates or agents; (iii) is in or enters the public domain through no fault of such Party or others within its control; (iv) is disclosed to a Party, without restriction or breach of the confidentiality obligations herein or any other obligation of confidentiality, by a third party who has the right to make such disclosure; or (v) is required to be disclosed in the course of any rate making proceeding of Sellers or their Affiliates.

6.4.4. Purchasers shall return or destroy all copies, whether physical or electronic, all materials that do not pertain, directly or indirectly to the Acquired Assets or Assumed Liabilities, the Transaction Agreements or the transactions contemplated hereunder.

6.5. **Plan for Transition of Employment.**

Purchasers and Sellers shall implement the plans for transition of employment set forth in Exhibits D-1 and D-2.

6.6. **Transfer Taxes.**

6.6.1. The Party legally responsible for a Transfer Tax shall be responsible for the timely payment of such Transfer Tax resulting from the transactions contemplated by this Agreement.

6.6.2. Purchasers shall be liable for and shall pay to Sellers an amount equal to any GST and PST payable by Purchasers and collectible by Sellers in connection with the transactions contemplated by this Agreement.

6.6.3. Purchasers acknowledge and agree that they are responsible for and shall pay all GST and PST pertaining to this transaction at Closing. The Parties shall execute and deliver such documents, notices and elections and do such lawful things, to endeavor to allow Purchasers to claim a full input tax credit with respect to, or obtain a refund of all GST so payable by Purchasers.

6.7. **Tax Matters.**

6.7.1. Other than any Taxes that may be imposed on Purchaser under Section 6.6, Sellers shall be solely liable for any Taxes attributable to any Acquired Assets with respect to any taxable period or portion thereof ending on or before the Effective Time, including any such Taxes attributable to such Assigned Contracts for a taxable period beginning before and ending after the Effective Time, which is allocable to the portion of such period occurring on or before the Effective Time.

6.7.2. Purchasers shall be solely liable for any Taxes attributable to any Acquired Assets with respect to any taxable period or portion thereof beginning after the Effective Time, including any such Taxes attributable to such Assigned Contracts for a taxable period beginning before and ending after the Effective Time, which is allocable to the portion of such period occurring after the Effective Time.

6.8. **Tax Certificates, etc.**

The Parties agree, upon request, to use their commercially reasonable efforts to obtain any certificate or other document as may be lawfully available to mitigate, reduce or eliminate any Taxes that could be imposed as a result of the transactions contemplated by the Transaction Agreements.

6.9. **Accounts Receivable and Accounts Payable.**

6.9.1. Accounts receivable generated by and accruing under the Assigned Contracts relating to periods prior to the Effective Time are not being transferred to Purchasers and shall be invoiced by Sellers and all payments received thereon shall belong to Sellers. All accounts payable of Sellers generated by and accruing under the Assigned Contracts relating to periods prior to the Effective Time shall remain the responsibility of Sellers.

6.9.2. Accounts receivable generated by and accruing under the Assigned Contracts on and after the Effective Time shall be invoiced by Purchasers and all payments received thereon shall belong to Purchasers. All accounts payable generated by and accruing under the Assigned Contracts on or after the Effective Time are the responsibility of Purchasers.

6.9.3. In the event that any Seller at any time receives any payment which is payable in whole or in part to any Purchaser pursuant to this Section 6.9, such payment shall be held in trust for such Purchaser and such Seller shall pay to such Purchaser, as soon as reasonably possible but in no event later than five (5) days after receipt by such Seller, the amount of the payment due such Purchaser, plus interest on such amount calculated at the Applicable Rate from the date of receipt of such payment by such Seller to the date on which payment is made to such Purchaser, pursuant to this Section 6.9 together with whatever supporting information is reasonably available. Similarly, if any Purchaser receives any payment that is payable in whole or in part to any Seller pursuant to this Section 6.9, such Purchaser shall hold such payment in trust for such Seller and pay such Seller, as soon as reasonably possible but in no event later than five (5) days after receipt by such Purchaser, the amount of the payment due to such Seller, plus interest on such amount calculated at the Applicable Rate from the date of receipt of such payment by such Purchaser to the date on which payment is made to such Seller, pursuant to this Section 6.9 together with whatever supporting information is reasonably available.

6.10. **Pipeline Imbalances**

Purchasers and Sellers recognize that various pipeline companies periodically reconcile their imbalance accounts between (a) the quantities of gas nominated by shippers for flow and (b) the quantities of gas actually received and delivered for the account of a shipper and that, as a consequence of

such reconciliation and depending on the circumstances, a shipper will be obligated to provide "in-kind makeup" (*i.e.*, deliver to, or receive from, the pipeline such quantities of gas as are necessary to eliminate the imbalance) or to make or receive "cashout" payments (payments made to or received from the pipeline to resolve the imbalance). To the extent any such reconciliation relates to gas transportation or storage occurring with respect to an Assigned Contract prior to the Effective Time or the value of the Natural Gas Inventory as of the Closing Date, (a) such Purchaser shall reimburse such Seller for any cash-out payments or the fair market value in cash of any gas received by such Purchaser relating to any such reconciliation as soon as possible, but in no event later than 30 days after receipt by such Purchaser of such cash-out payment or gas and (b) such Seller shall reimburse such Purchaser for any cash-out payments or the fair market value in cash of any gas delivered by such Purchaser relating to any such reconciliation as soon as possible after receiving notice thereof from such Purchaser, but in no event later than 30 days after receipt by such Seller of such notice. This Section 6.10 shall only be applicable from the Effective Time through ninety days after the Effective Time. Sellers shall use commercially reasonable efforts to minimize the pipeline imbalances before the Effective Time.

6.11. **Deemed Assignment of Contracts.**

The Parties agree to implement the provisions of Section 2.6.

## 7. Purchasers' Conditions to Closing.

The obligation of Purchasers to close the transactions contemplated hereunder and in the Transaction Agreements is subject to the fulfillment, on or before the Effective Time, of each of the conditions set forth in this Section 7 (except to the extent waived in writing by each Purchaser in its sole discretion, or as otherwise specifically limited below).

7.1. **Representations and Warranties**

Each of the representations and warranties made by Sellers in Section 3 of this Agreement shall be true in all material respects on and as of the Closing Date as though made on and as of such date or, in the case of representations and warranties made as of a specified date earlier than the Closing Date, on and as of such earlier date.

7.2. **Performance.**

Sellers shall have performed and complied, in all material respects, with the agreements, covenants and obligations required by this Agreement to be so performed or complied with by Sellers at or before the Effective Time.

7.3. **Deliveries.**

Sellers shall have made all deliveries required of them under Section 2.10.

7.4. **Orders and Laws.**

There shall not be any litigation or proceedings (filed by a Person other than Purchasers or their Affiliates) or Law or order restraining, enjoining or otherwise prohibiting or making illegal or threatening to restrain, enjoin or otherwise prohibit or make illegal the consummation of any of the transactions contemplated by this Agreement.

7.5. **Consents and Approvals.**

The approvals, consents and authorizations listed in Section 3.3.5 of the Seller Disclosure Schedule and on Schedules 2.2.1(d) and 2.10.16 shall have been duly obtained, made or given and shall be in full force and effect, and all terminations or expirations of waiting or appeal periods imposed by any Governmental Authority shall have occurred.

8. **Sellers' Conditions to Closing.**

The obligation of Sellers to close the transactions contemplated herein and in the Transaction Agreements is subject to the fulfillment, on or before the Effective Time, of each of the conditions set forth in this Section 8 (except to the extent waived in writing by each Seller in its sole discretion, or as otherwise specifically limited below):

8.1. **Representations and Warranties.**

Each of the representations and warranties made by Purchasers in Section 4 of this Agreement shall be true in all material respects on and as of the Effective Time as though made on and as of such date or, in the case of representations and warranties made as of a specified date earlier than the Closing Date, on and as of such earlier date.

8.2. **Performance.**

Purchasers shall have performed and complied, in all material respects, with the agreements, covenants and obligations required by this Agreement to be so performed or complied with by Purchasers at or before the Effective Time.

8.3. **Deliveries.**

Purchasers shall have taken all actions and made all deliveries required of them under Section 2.11.

8.4. **Orders and Laws.**

There shall not be any litigation or proceedings (filed by a Person other than Sellers or their Affiliates) or Law or order restraining, enjoining or otherwise prohibiting or making illegal or threatening to restrain, enjoin or otherwise prohibit or make illegal the consummation of any of the transactions contemplated by this Agreement.

8.5. **Consents and Orders.**

Any approvals, consents and authorizations required to be obtained by each Purchaser to execute and deliver this Agreement, perform its obligations hereunder and consummate the transactions contemplated hereby shall have been duly obtained, made or given and shall be in full force and effect, and all terminations or expirations of waiting or appeal periods imposed by any Governmental Authority shall have occurred.

9. **Termination.**

9.1. **Termination.**

9.1.1. By written agreement, Purchasers and Sellers may mutually agree to terminate this Agreement at any time prior to the Effective Time.

9.1.2. Either Purchasers or Sellers may terminate this Agreement and all of the Transaction Agreements prior to the Effective Time by giving written notice to the other Parties in the event that any Governmental Authority shall have issued an order or taken any other action restraining, enjoining or otherwise prohibiting the transactions contemplated herein or by the Transaction Agreements and such order shall have become final and non-appealable.

9.1.3. Sellers may terminate this Agreement prior to the Effective Time if Purchasers fail to fulfill the conditions set forth in Section 8 no later then the Effective Time and such failure has not been cured within fifteen (15) days of written notice provided by Sellers to Purchasers of such failure.

9.1.4. Purchasers may terminate this Agreement prior to the Effective Time if Sellers fail to fulfill the conditions set forth in Section 7 no later then the Effective Time and such failure has not been cured within fifteen (15) days of written notice provided by Purchasers to Sellers of such failure.

9.2. **Effect of Termination.**

If this Agreement is validly terminated pursuant to Section 9.1.4 by Purchasers due to Sellers' failure to satisfy the condition set forth in Section 7.2 or by Sellers pursuant to Section 9.1.3 due to Purchasers' failure to satisfy the condition set forth in Section 8.2, the terminating Party shall be entitled to all rights and remedies available to it under Law or equity; provided, however, that in no event shall any Party have any obligation or liability arising under this Agreement or relating to the Transaction Agreements (or any other agreement, document or certificate delivered in connection with the transactions contemplated by the Transaction Agreements) for any consequential, punitive, special or indirect loss or damage, including lost profits or lost opportunities, and each Party hereby expressly releases the other Parties from the same; provided, further, that the maximum aggregate liability of Sellers and their Affiliates under this Section 9.2 shall in no event exceed an amount equal to $30,000,000.

10. **Non-Competition Provision.**

10.1. **Restrictions on Replication or Expansion of the Business.**

10.1.1. Subject to Section 10.1.3, Sellers, Avista Capital and Avista Corporation, each for itself and on behalf of its Affiliates (collectively, the "**Avista Group**"), agree that for a period of sixty (60) calendar months beginning at the Effective Time, no member of the Avista Group will form or participate through ownership or any alliance, or internally, develop capabilities to replicate the business of the Sellers within the region of the Western Electric Coordinating Council (the "**Western Region**"). Such capabilities include, without limitation, (i) the development of sales force activity or marketing activity within the Western Region at wholesale or at the end-use level if geographically outside the Avista Group's utility service area, which shall include any service areas gained as a result of a merger, acquisition or other similar transaction, and (ii) dealing, market-making, clearing and brokering Commodity Transactions within the Western Region at wholesale or at the end-use level if geographically outside of the Avista Group's utility service area, which shall include any service areas gained as a result of a merger, acquisition or other similar transaction.

10.1.2. Subject to Section 10.1.3, Sellers, Avista Capital and Avista Corporation, each for itself and on behalf of its Affiliates, agree that for a period of sixty (60) calendar months beginning as of the Effective Time, each member of the Avista Group will not, either directly or indirectly, carry on or engage in, as an individual, owner, part-owner, manager, operator, employee, sales person, agent or other participant, in the business of marketing of natural gas and liquids derived therefrom, electricity, or any alternative energy source in the Western Region at wholesale or at the end-use level if geographically outside the Avista Group's utility service area, which shall include any service areas gained as a result of a merger, acquisition or other similar transaction.

10.1.3. Purchasers agree that in no event shall the activities and transactions undertaken in the ordinary and usual course by the Avista Group engaged in the regulated utility lines of business be construed as violating the covenants set forth in Sections 10.1.1 and 10.1.2, including such activities that pertain only to the business of the utility, purchases of the Avista Group's deficit energy at wholesale, sales of the Avista Group's surplus energy at wholesale, sales of the Avista Group's control area services, ancillary services or other services as part of optimization of its resources or as part of acquisition of all or a materially (i.e., greater than 10%) portion of the output of a new resource, the continuation or extension of existing optimization transactions presently engaged in by the utility or the entry into any transmission projects. Additionally, Purchasers agree that the activities of Advantage IQ, Inc., related to its customers' electric, natural gas, telephone and other utility services shall not be construed as violating the covenants set forth in Sections 10.1.1 and 10.1.2. Purchasers further agrees that in the event any member of the Avista Group succeeds to a line of business as a result of an acquisition transaction, purchase, reorganization or otherwise involving other lines of business and such line of business violates the covenants set forth in Sections 10.1.1 and 10.1.2, then such member of the Avista Group shall have a period of one (1) year from the date of such event to discontinue or otherwise dispose of such offending line of business.

10.1.4. Sellers' optimization of the generating facility that is the subject of the Lancaster Energy Conversion Agreement upon expiration of that agreement is permissible without regard to the prohibitions set forth in Sections 10.1.1 and 10.1.2.

10.1.5. Sellers, Avista Capital and Avista Corporation each acknowledge and agree that the restrictions set forth in this Section 10.1 are reasonably designed to protect Purchasers' substantial investment and are reasonable with respect to duration, geographical area and scope.

10.1.6. Avista Capital agrees that, for a period of sixty (60) calendar months beginning as of the Effective Time, it shall cause Avista Energy and Avista Turbine to refrain from conducting any business other than the businesses conducted by them as of the date of this Agreement.

10.2. **Remedies Upon Breach.**

In the event of breach by any Person of any of the provisions of Sections 10.1.1 and 10.1.2, Purchasers may, in addition to any other rights or remedies existing in its favor, apply to any court of competent jurisdiction for specific performance or injunctive or other relief in order to enforce or prevent any violations of the provisions of Sections 10.1.1 and 10.1.2. In the event of a breach or violation by any such Person of any of the provisions of Sections 10.1.1 and 10.1.2 established by any court of competent jurisdiction, without reversal or appeal, the sixty month period described therein will be tolled with respect to such Person until such breach or violation is resolved.

11. **Public Announcements.**

From the date of this Agreement and for a period of six (6) months after the Closing Date, no Party shall issue any press release or make any public announcement relating to the subject matter of this Agreement or any of the Transaction Agreements except as may be agreed by at least one Seller and one Purchaser in advance in writing unless the disclosing Party believes in good faith that such public disclosure is required by applicable Law or any listing or trading agreement concerning its publicly-traded securities (in which case the disclosing Party will use its commercially reasonable efforts to advise the other Parties prior to making the disclosure). Notwithstanding anything to the contrary in the foregoing, following the Effective Time, any Party may make any public announcement relating to the subject matter of the transactions contemplated herein as it deems necessary or advisable in connection with the filing of its periodic and current reports with the Securities and Exchange Commission.

12. **Miscellaneous**

12.1. **No Third Party Beneficiaries.**

This Agreement shall not confer any rights or remedies upon any Person other than the Parties, and their respective successors and permitted assigns and any indemnified party pursuant to the Indemnification Agreement.

12.2. **Entire Agreement.**

This Agreement and the Transaction Agreements (including the documents referred to in this Agreement) constitute the entire agreement among the Parties and supersede any prior understandings, agreements or representations by or among the Parties, written or oral, to the extent they related in any way to the subject matter of this Agreement

12.3. **Succession and Assignment**

This Agreement shall be binding upon and inure to the benefit of the Parties named in this Agreement and their respective successors and permitted assigns. No Party may assign either this Agreement or any of its rights, interests or obligations under this Agreement without the prior written approval of the other Parties.

12.4. **Counterparts.**

This Agreement may be executed in one or more counterparts, each of which shall be deemed an original but all of which together will constitute one and the same instrument.

12.5. **Headings.**

The section headings contained in this Agreement are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Agreement.

12.6. **Notices.**

All notices, Claims and other communications under this Agreement will be in writing. Any notice, Claim or other communication under this Agreement shall be deemed duly given if it is sent to the intended recipient as set forth below.

**If to Sellers:**

Avista Energy, Inc.
Avista Energy Canada, Ltd.
c/o Avista Capital, Inc.
1411 East Mission Avenue
Spokane, Washington 99202
Facsimile: (509) 495-4361
Attn.: President

With copies to:

Avista Corporation

1411 East Mission Avenue
Spokane, Washington 99202
Facsimile: (509) 495-4361
Attn: General Counsel

Avista Capital, Inc., as Guarantor
1411 East Mission Avenue
Spokane, Washington 99202
Facsimile: (509) 495-4361
Attn: General Counsel

and to:

Heller Ehrman LLP
701 Fifth Avenue, Suite 6100
Seattle, Washington 98104
Facsimile: (206) 447-0849
Attn.: Bruce M. Pym

**If to Purchasers:**

Coral Energy Holding, L.P.
Coral Energy Resources, L.P.
Coral Power, L.L.C.
4445 Eastgate Mall
Suite 100
San Diego, California 92121
Facsimile: 713-767-5699
Attn.: Senior Vice President

Coral Energy Canada Inc.
3500, 450-1st Street S.W.
Calgary, Alberta Canada
T2P 5H1
Facsimile: 403-716-3501
Attn: Senior Vice President

With a copy to:

Coral Energy Holding, L.P.
909 Fannin, Plaza Level 1
Houston, Texas 77010
Facsimile: 713-230-2900
Attn: General Counsel

Any Party may send any notice, Claim or other communication under this Agreement to the intended recipient at the address set forth above using personal delivery, expedited or overnight courier, messenger service, facsimile or ordinary mail, but no such notice, Claim or other communication shall be deemed to have been duly given unless and until it actually is received by or at the address or number of the intended recipient as specified in this Section 12.6. Any Party may change the address to which notices, Claims and other communications under this Agreement are to be delivered by giving the other Parties notice in the manner set forth in this Agreement

12.7. **Governing Law.**

This Agreement shall be governed by and construed in accordance with the domestic laws of the State of New York without giving effect to any choice or conflict of law provision or rule (whether under 5-1401 and 5-1402 of the New York General Obligations Law or any other jurisdiction) that would cause the application of the Laws of any jurisdiction other than the State of New York.

12.8. **Amendments and Waivers.**

No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by all of the Parties. No waiver by any Party of any default, misrepresentation or breach of warranty or covenant under this Agreement, whether intentional or not, shall be deemed to extend to any prior or subsequent default, misrepresentation or breach of warranty or covenant under this Agreement or affect in any way any rights arising by virtue of any prior or subsequent such occurrence.

12.9. **Severability.**

Any term or provision of this Agreement that is invalid or unenforceable in any situation in any jurisdiction shall not affect the validity or enforceability of the remaining terms and provisions of this Agreement or the validity or enforceability of the offending term or provision in any other situation or in any other jurisdiction.

12.10. **Expenses.**

Except as expressly provided in this Agreement, each of the Parties will bear its own costs and expenses (including legal fees and expenses) incurred in connection with this Agreement and the transactions contemplated herein and by the Transaction Agreements.

12.11. **Specific Performance.**

Each of the Parties acknowledges and agrees that the other Parties would be damaged irreparably in the event any of the provisions of this Agreement are not performed in accordance with their specific terms or otherwise are breached. Accordingly, each of the Parties agrees that the other Parties shall be entitled to an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically this Agreement and its terms and provisions in any action instituted in any court of the United States or any state having jurisdiction over the Parties and the matter, in addition to any other remedy to which they may be entitled, at law or in equity.

*****

REMAINDER OF PAGE INTENTIONALLY LEFT BLANK

EXECUTED effective as of the date first above written.

CORAL ENERGY HOLDING, L.P.,
a Delaware limited partnership

By: /s/ Mark Hanafin
Name: Mark Hanafin
Title: President and Chief Executive Officer

CORAL ENERGY RESOURCES, L.P.,
a Delaware limited partnership

By: /s/ Mark Hanafin
Name: Mark Hanafin
Title: President and Chief Executive Officer

CORAL POWER, L.L.C.
a Delaware limited liability company

By: /s/ Mark Hanafin
Name: Mark Hanafin
Title: President and Chief Executive Officer

CORAL ENERGY CANADA INC.
an Alberta, Canada corporation

By: /s/ Arnold MacBurnie
Name: Arnold MacBurnie
Title: Senior Vice President

AVISTA ENERGY, INC.,
a Washington corporation

By: /s/ Gary G. Ely
Name: Gary G. Ely
Title: Chairman and CEO

AVISTA ENERGY CANADA, LTD.,
An amalgamated corporation of the Province of Alberta, Canada

By: /s/ Gary G. Ely
Name: Gary G. Ely
Title: Director and CEO

By signing below, Avista Corporation hereby acknowledges and agrees to be bound by and comply with the provisions of Section 10 of this Agreement.

AVISTA CORPORATION,
a Washington corporation

By: /s/ Gary G. Ely
Name: Gary G. Ely
Title: Chairman and CEO

By signing below, Avista Capital, Inc. hereby acknowledges and agrees to be bound by and comply with the provisions of Section 10 of this Agreement.

AVISTA CAPITAL, INC.
a Washington corporation

By: /s/ Gary G. Ely
Name: Gary G. Ely
Title: Chairman, President and CEO

SIGNATURE PAGE TO PURCHASE AND SALE AGREEMENT

## APPENDIX A – DEFINITIONS

As used in this Agreement, the following defined terms have the meanings indicated below:

"**Acquired Assets**" means those assets and obligations being expressly acquired and assumed as set forth below:

A. The Assigned Contracts:

i. The enabling agreements, active confirmations and open transactions supporting Sellers' Trade Book as of the Effective Time and other active or newly executed contracts;

ii. The Sellers' enabling agreements that may not have an open position as of the Effective Time, but under which one or more transactions have been consummated since September 30, 2005;

iii. All of Sellers' pipeline transportation agreements *except* for the Service Agreements Applicable to Firm Transportation Service Under Rate-Schedule FS-1 between Avista Energy and each of TransCanada PipeLines Limited (Alberta System)(Contract No. 2004175615-2) and TransCanada PipeLines Limited (British Columbia System)(Contract No. AVIS-F5), each dated November 1, 2004 with an aggregate maximum day delivery quantity of 27,841 giga joules/day and a service termination date of October 31, 2017;

iv. All of Sellers' transmission agreements as represented by those agreements *except* the Service Agreement for Point-to-Point Transmission executed by the United States of America Department of Energy acting by and through the Bonneville Power Administration and Avista Energy, Inc., as amended (Service Agreement No. 97TX-50002) for 250 MW of power originally dated July 25, 1997;

v. All of Sellers' energy management and associated agreements;

vi. The Natural Gas Intrastate Storage Service Agreement dated April 1, 2006 by and between NorthWestern Corporation doing business as NorthWestern Energy and Avista Energy, Inc. as may have been amended from time to time;

vii. Cochrane Extraction Agreement – Priority Gas letter agreement dated October 1, 2005 by and between Avista Energy Inc. and COCHRANE/EMPRESS V PARTNERSHIP; and

viii. Any contract or agreement incidental to the foregoing.

B. The Assumed Leases.

C. Office furniture utilized in the Spokane, Washington; Vancouver, British Columbia and Great Falls, Montana locations.

D. Any telemetry and other miscellaneous equipment utilized by Sellers to monitor generator facilities.

E. The software and computer hardware listed on Schedule A-1.

F. Customer lists, know-how and going concern value (excluding the "Avista" name).

G. Working Natural Gas Inventory.

"**Affiliate**" means a Person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with a Party. For this purpose, control means the direct or indirect ownership of, in the aggregate, fifty percent (50%) or more of voting capital.

"**Agency Agreement**" means the Agency Agreement to be agreed upon and entered into by Purchasers and Sellers in the form attached hereto as Exhibit A.

"**Agreement**" has the meaning set forth in the introduction to this Agreement.

"**Applicable Rate**" means the rate of interest determined by reference to the U.S. Dollar London Interbank Offer Rate (LIBOR) quoted on Bloomberg page BBAM applicable for the relevant one-month period (or any successor or substitute page of such publication, or any successor to or substitute for such publication, providing rate quotations comparable to those currently provided on such page of such publication) at approximately 11:00 a.m., London time, two (2) Business Days prior to the commencement of such interest period.

"**Arbitrator**" has the meaning set forth in Section 2.2.2(f).

"**Assigned Contracts**" means the contracts, transactions, confirmations or other agreements set forth in the definition of Acquired Assets which, when taken as a whole, represent substantially all of the business of the Sellers being acquired and assumed by Purchasers.

"**Assignments**" means the Assignment and Novation Agreements among the applicable Seller, Purchaser and Counterparty with respect to the Assigned Contracts, which shall be substantially in the form attached hereto as Exhibit B, together with such changes therein as may be mutually acceptable to the applicable Seller and Purchaser as individual circumstances warrant.

"**Assumed Leases**" means the leases for the office premises in Spokane, Washington, Great Falls, Montana and Vancouver, British Columbia.

"**Assumed Liabilities**" means all Claims, obligations and liabilities under or in connection with the Acquired Assets, including the Assigned Contracts, sold, transferred and conveyed from Sellers to Purchasers in accordance with the terms of this Agreement, to the extent such Claims, obligations or losses with respect to such Acquired Assets arise after the Effective Time, but not on or prior to the Effective Time.

"**Avista Canada**" has the meaning set forth in the introduction to this Agreement.

"**Avista Capital**" means Avista Capital, Inc., a Washington corporation.

"**Avista Energy**" has the meaning set forth in the introduction to this Agreement.

"**Avista Group**" has the meaning set forth in Section 10.1.1.

"**Avista Turbine**" means Avista Turbine Power, Inc.

"**BPA Transmission Agreement**" means that certain Service Agreement for Point-to-Point Transmission, Agreement No. 97TX-50002, dated on or about July 24, 1997 between Avista Energy, Inc. and the United States of America, Department of Energy, acting by and through the Bonneville Power Administration and Bonneville Power Administration, as amended or supplemented by the following:

Amendment No. 1 to Point-to-Point Transmission Service, Contract No 97TX-50002 dated June 20, 2000;

Amendatory Agreement No. 2—Service Agreement for Point to Point Transmission Service dated June 7, 2004;

Exhibit K—Revision No. 1 Special Provisions dated December 15, 2004;

Exhibit K—Revision No. 2 Special Provisions dated January 4, 2005;

Notification of Real Power Loss Provider dated February 14, 2005;

Revision 1, Exhibit C Table 1—Statement of Specifications for Long Term Firm Transmission Service dated July 5, 2000;

Revision 1, Exhibit C Table 2 -Statement of Specifications for Long Term Firm Transmission Service dated September 28, 2000;

Revision No 2, Exhibit C Table 1 dated May 11, 2004;

Revision No. 1—Exhibit J Ancillary Services dated September 30, 1997;

Revision No. 2—Exhibit J dated August 5, 1999;

Revision No. 4—Exhibit J Ancillary Services dated August 21, 2002;

Revision No. 5—Exhibit J Ancillary Services dated December 1, 2005; and

Service Agreement for Point to Point Transmission dated July 31, 1997.

"**Business Day**" means a day other than Saturday, Sunday or any day on which banks located in the State of New York are authorized or obligated to close.

"**Canada Tax Act**" means the *Income Tax Act* (Canada).

"**Canadian Pipeline Agreements**" has the meaning set forth in Section 2.5.

"**Canadian Pipelines**" has the meaning set forth in Section 2.5.

"**Canadian Withholding Tax Amount**" means an amount equal to the applicable withholding rate for the Purchased Taxable Canadian Property times the amount (if any) by which the Taxable Canadian Property Purchase Price exceeds the Canadian Withholding Tax Certificate Limit.

"**Canadian Withholding Tax Certificate**" means the tax clearance certificate issued by the CRA pursuant to section 116 of the Canada Tax Act.

"**Canadian Withholding Tax Certificate Limit**" means the certificate limit (as that term is used in subsection 116(2) of the Canada Tax Act) as set forth in the Canadian Withholding Tax Certificate with respect to the Purchased Taxable Canadian Property, provided however, that until the Canadian Withholding Tax Certificate is delivered to Purchasers, the Canadian Withholding Tax Certificate Limit shall be deemed to be zero.

"**Canadian Withholding Tax Escrow Agent**" means Stikeman, Elliott, LLP.

"**Canadian Withholding Tax Escrow Agreement**" means the Canadian Withholding Tax Escrow Agreement to be entered into by and among Avista Energy, Inc., Coral Energy Canada Inc. and the Canadian Withholding Tax Escrow Agent in substantially the form attached hereto as Exhibit P.

"**Canadian Withholding Tax Escrow Amount**" means an amount equal to the applicable withholding rate for the Purchased Taxable Canadian Property times the amount (if any) by which the Taxable Canadian Property Purchase Price exceeds the Canadian Withholding Tax Certificate Limit set forth in the application for the Canadian Withholding Tax Certificate (if any) provided to Purchasers at or before the Closing.

"**Canadian Withholding Tax Remittance Date**" means the later of (i) the 27th day following the end of the calendar month that includes the Closing Date; and (ii) such later date, in lieu of the deadline specified in subsection 116(5) or (5.3), as applicable, of the Canada Tax Act, that CRA confirms in writing to Purchasers, in form and substance acceptable to Purchasers, acting reasonably, provided that a copy of such confirmation has been delivered to Purchasers and the Canadian Withholding Tax Escrow Agent before the time described in (i) above.

"**Charter Documents**" means with respect to any Person, the articles of incorporation, amalgamation, organization or association and by-laws, the limited partnership agreement or the limited liability company agreement, including those that are required to be registered or lodged in the place of incorporation, organization or formation of such Person and which establish the legal personality of such Person or any such similar document.

"**Claim**" means any action, suit, proceeding, investigation, charge, complaint, claim or demand.

"**Closing Date**" shall mean the Business Day which includes the Effective Time or, if the day which includes the Effective Time is not a Business Day, the first Business Day which immediately precedes the day which includes the Effective Time.

"**Code**" means the Internal Revenue Code of 1986, as amended.

"**Commissioner**" means the Commissioner of Competition appointed pursuant to the Competition Act.

"**Commodity**" means natural gas, electricity and energy in any form (including capacity, installed capacity or any other ancillary service) related to electricity in all cases under the Assigned Contracts.

"**Commodity Service Agreements**" means agreements for asset optimization and energy management services related to the provision and management of Commodity Transactions excluding end-use natural gas customers in Montana and Canada.

"**Commodity Transactions**" means spot, forward, futures, option, park and loan, swap, exchange, sale, purchase and repurchase transactions, tolling transactions, energy conversion agreements, rights relating to the transportation, transmission or storage of any Commodity, ancillary products, foreign currency contracts used to mitigate currency exposure related to commodity purchases and sales denominated in Canadian dollars, and any combination of the foregoing and similar transactions involving Commodities and other commodities the price of which is substantially related to the price or availability of natural gas or electricity (including financial derivative products relating to the foregoing).

"**Commodity Valuation Methodology**" has the meaning set forth in Section 5.3.2.

"**Competition Act**" means the *Competition Act*, R.S.C. 1985, c. C-34(Canada), as amended.

"**Competition Act Approval**" means in respect of the transactions contemplated under this Agreement and the Transaction Agreements:

(a) an advance ruling certificate pursuant to Section 102 of the Competition Act has been issued by the Commissioner; or

(b) a "no action letter" has been received from the Commissioner stating that the Commissioner has determined that she does not at that time intend to make an application for an order under Section 92 of the Competition Act in respect of the purchase or assets sales contemplated hereunder, and waiving the notification obligations of the Parties under Part IX of the Competition Act pursuant to Section 113(c) of the Competition Act, failing which waiver, the notification material required by Part IX of the Competition Act shall have been filed and any applicable waiting period thereunder shall have expired or been earlier terminated.

"**Coral Canada**" has the meaning set forth in the introduction to this Agreement.

"**Coral Holding**" has the meaning set forth in the introduction to this Agreement.

"**Coral Power**" has the meaning set forth in the introduction to this Agreement.

"**Coral Resources**" has the meaning set forth in the introduction to this Agreement.

"**Counterparties**" means each of the Parties to the Assigned Contracts, other than Seller.

"**CRA**" means the Canada Revenue Agency.

"**Credit Agreement**" that certain Third Amended and Restated Credit Agreement, dated as of July 25, 2003, by and among BNP Paribas, as Administrative Agent, Collateral Agent, an Issuing Bank, and a Bank; Fortis Capital Corp., as Documentation Agent, an Issuing Bank, and a Bank; Natexis Banques Populaires, as a Bank; the other financial institutions which may become a party to such agreement from time to time and the Avista Energy and Avista Canada, as the Co-Borrowers, as such agreement has been amended or modified from time to time

"**Credit Policy**" means Sellers' policies and procedures related to credit and counterparty risk, and related mandates, directives and procedures adopted by each of the Sellers and in effect as of December 31, 2005, through the date of this Agreement, a copy of which is contained in the Data Room.

"**Data Room**" means the electronic data room by which Sellers delivered or provided documents and files to Purchasers and their authorized representatives.

"**Disclosed Personal Information**" means any Personal Information disclosed to Purchasers.

"**DOJ**" has the meaning set forth in Section 5.1.1(a).

"**Effective Time**" means, unless otherwise agreed to by the Parties in writing, the later of (i) 11:59 p.m. June 30, 2007 or (ii) 11:59 p.m. on the last day of the month following the date the Assignor and Assignee receive the necessary regulatory consents specified in Section 5.1 or, if such regulatory consents are received on or after the fifteenth day of the month, at 11:59 p.m. on the last day of the month following the month in which such regulatory consents are received.

"**Electronically Recorded Trade Book**" means Sellers' detailed listing of all Commodity Transactions of Sellers that form a portion of the basis for the "energy commodity assets" and "energy commodity liabilities" in Sellers' financial statements as such assets and liabilities may be determined on any date by applying the Commodity Valuation Methodology and as presented in an electronic format substantially similar to that provided to Purchasers as of March 31, 2007 on April 4, 2007.

"**Employee Arrangement**" means any arrangement, policy, practice, contract or agreement that is not an Employee Benefit Plan that provides fringe benefits, supplemental unemployment, bonus, incentive, profit-sharing, termination pay, severance, stock option, stock purchase, phantom stock, stock appreciation rights, deferred compensation, workers' compensation, retirement, life, health, welfare, leave, vacation, disability, death or similar employee benefits.

"**Employee Benefit Plan**" means (a) any non-qualified deferred compensation or retirement plan or arrangement that is an Employee Pension Benefit Plan, (b) qualified defined contribution retirement plan or arrangement that is an Employee Pension Benefit Plan, (c) qualified defined benefit retirement plan or arrangement that is an Employee Pension Benefit Plan (including any Multiemployer Plan) or (d) Employee Welfare Benefit Plan or material fringe benefit plan or program.

"**Employee Pension Benefit Plan**" has the meaning set forth in Section 3(2) of ERISA.

"**Employee Welfare Benefit Plan**" has the meaning set forth in Section 3(1) of ERISA.

"**ERISA**" means the Employee Retirement Income Security Act of 1974, as amended.

"**Escrow Agreement**" means the Escrow Agreement to be entered into between Purchasers, Sellers and Avista Corporation substantially in the form attached hereto as Exhibit O.

"**Estimate Date**" means last day of the month immediately preceding the month that includes the Effective Time.

"**Estimated Purchase Price**" has the meaning set forth in Section 2.2.2(a)(i).

"**Excluded Assets**" means all of the assets of the Sellers, other than the Acquired Assets, including the following:

1. Cash;
2. Accounts receivable generated by Sellers from transactions which occur prior to the Effective Time;
3. Software, hardware, licenses and permits other than those set forth in Schedule A-1;
4. Corporate records (other than the Assigned Contracts);
5. Historical goodwill as reflected on Sellers' balance sheet;
6. Confidentiality Agreements;
7. Enabling agreements under which no activity has occurred since August 31, 2005;
8. All employment contracts, severance agreements or employment related obligations except to the extent such obligations relate to the Avista Canada employees and are required by applicable Canadian Law to be assumed by Purchasers;
9. Agreement to extend the Agreement to Convey Ownership Interest in Jackson Prairie Storage Expansion originally dated October 5, 1998, by and between Avista Corporation and Avista Energy, Inc., as amended, and all amendments thereto and the extension thereof as set forth in Exhibit Q to be executed by and between Avista Corporation and Avista Energy prior to the Closing Date;
10. Cushion natural gas in Jackson Prairie;
11. Service Agreement for Point-to-Point Transmission executed by the United States of America Department of Energy acting by and through the Bonneville Power Administration and Avista Energy, Inc., as amended (Service Agreement No. 97TX-50002) for 250 MW of power originally dated July 25, 1997;
12. Service Agreements Applicable to Firm Transportation Service Under Rate-Schedule FS-1 between Avista Energy and each of TransCanada PipeLines Limited (Alberta System)(Contract No. 2004175615-2) and TransCanada PipeLines Limited (British Columbia System)(Contract No. AVIS-F5), each dated November 1, 2004 with an aggregate maximum day delivery quantity of 27,841 giga joules/day and a service termination date of October 31, 2017; and
13. All other contracts, agreements and assets, other than the Acquired Assets.

"**FERC**" shall mean the Federal Energy Regulatory Commission.

"**FERC Order Authorizing the Disposition of Jurisdictional Facilities Under Section 203 of the FPA**" means that certain filing made by Sellers as required pursuant to Section 203 of the FPA to the FERC substantially in the form attached hereto as Exhibit E authorizing Sellers to dispose of jurisdictional facilities as described therein and receipt of final approval from the FERC, without a right of review or appeal, approving such request unless otherwise waived by the Parties in writing.

"**Fixed Transactions**" means Commodity Transactions arising out of transmission, transportation, energy conversion, storage, storage facilities and tolling agreements and the Commodity Service Agreements.

"**FPA**" means the United States Federal Power Act, as amended.

"**FTC**" has the meaning set forth in Section 5.1.1(a).

"**GAAP**" means generally accepted accounting principles in the United States of America, consistently applied throughout the specified period.

"**Governmental Authority**" means any court, tribunal, arbitrator, authority, agency, commission, official or other regulatory body or instrumentality of the United States or Canada, any other nation or any domestic or foreign state, province, county, city or other political subdivision or similar governing entity.

"**GST**" means the goods and services tax imposed by the *Excise Tax Act* (Canada).

"**GTN Capacity Release Agreement**" means the Letter Agreement between Avista Energy, Inc. and Coral Energy Resources, L.P. for the Prearranged Temporary Release of Firm Transportation Capacity on Gas Transmission Northwest Corporation's System substantially in the form attached hereto as Exhibit F.

"**Guaranty**" means the Guaranty to be given by Avista Capital to Purchasers substantially in the form attached hereto as Exhibit G.

"**Indemnification Agreement**" means the Indemnification Agreement entered into by and among each of the Purchasers, each of the Sellers and Avista Turbine substantially in the form attached hereto as Exhibit H.

"**Interstate Pipeline and Storage Contracts**" has the meaning set forth in Section 2.4.

"**Intrastate Pipeline Contract**" means firm transportation contracts with pipelines located in the United States that are not subject to the jurisdiction of the FERC.

"**Investment Canada Act**" means the *Investment Canada Act* R.S., 1985, c. 28 (1st Supp.) (Canada), as amended.

"**IRS**" means the United States Internal Revenue Service.

"**Jackson Prairie**" means the Jackson Prairie gas storage facility, a natural gas storage facility located near Jackson Prairie, Lewis County, Washington.

"**Jackson Prairie Capacity Release Agreement**" means the Agreement to Release Jackson Prairie Storage Capacity between Avista Energy and Coral Resources in substantially the form attached hereto as Exhibit I.

"**Jackson Prairie Limited Jurisdiction Certificate**" means the limited jurisdiction certificate in substantially the form attached to this Agreement as Exhibit J issued by the FERC that authorizes Avista Energy to release storage capacity at Jackson Prairie to Coral Resources.

"**Knowledge**" means the actual knowledge of Sellers after reasonable investigation. For purposes of this definition, "actual knowledge" and "reasonable investigation" shall mean and are limited to actual knowledge, or such knowledge as Sellers should have possessed, based on due inquiry of those directors, officers and employees of Sellers and their Affiliates who are identified in the Seller Disclosure Schedule.

"**Lancaster Energy Conversion Agreement**" means the Energy Conversion Agreement between Avista Turbine and Coral Power in substantially the form attached hereto as Exhibit K.

"**Laws**" means any legislation, promulgation, constitution, law, ordinance, principle of common law, code, rule, regulation, order, pronouncement, statute or treaty of any Governmental Authority.

"**Lien**" means a lien, claim, charge, security interest or other encumbrance.

"**Loss**" means any and all judgments, losses, liabilities, amounts paid in settlement, damages, fines, penalties, deficiencies, and expenses (including interest, court costs, reasonable fees of attorneys, accountants and other experts or other reasonable expenses of litigation or other proceedings or of any Claim, default or assessment).

"**Manually Recorded Commodity Transactions**" means Sellers' detailed listing of Commodity Transactions of Sellers that, in conjunction with the Electronically Recorded Trade Book, forms the entire basis for the "energy commodity assets" and "energy commodity liabilities" in Sellers' financial statements, as such assets and liabilities may be determined on any date by applying the Commodity Valuation Methodology

"**Market Value**" means the mutually agreed prompt month forward price for the month following the month in which the Effective Time occurs, of (i) the Sumas, Washington first of the month index for Jackson Prairie storage inventory; (ii) the Terasen Exchange balances, and pipeline imbalances (excluding imbalances relating to Avista Canada), (iii) the AECO first of the month index minus $0.15 per MMBtu for Montana storage inventory and related pipeline imbalances and (iv) the AECO first of the month index for the Interior and PNG pipeline imbalances and Sumas first of the month index for the Lower Mainland pipeline imbalances. If the Parties cannot reach agreement, the price shall be the average mid-point of broker quotes from TFS Energy, LLC and Prebon Energy Inc.

"**Montana Natural Gas Facility**" means Sellers' rights to natural gas storage at the Dry Creek and Cobb, Montana storage facilities pursuant to the agreement dated April 1, 2006 between North Western Corporation doing business as North Western Energy and Avista Energy providing for 185,000 dekatherms of Dry Creek storage capacity and 555,000 dekatherms of Cobb storage capacity.

"**National Energy Board**" means the National Energy Board of Canada.

"**Natural Gas Inventory**" means working natural gas reduced by the volume in MMBtu of any exchange balances and increased or reduced by any pipeline imbalances.

"**Net Trade Book Value**" means the total "energy commodity assets" less "energy commodity liabilities" as reflected on Sellers' balance sheets prepared in accordance with GAAP.

"**NOVA/ANG Capacity Assignment**" means the Letter Agreement between Coral Energy Canada Inc. and Avista Energy, Inc. for the Prearranged Temporary Release of Firm Transportation Capacity on TransCanada Pipelines Limited's NOVA Gas Transmission Ltd. and Alberta Natural Gas pipeline systems substantially in the form attached hereto as Exhibit L.

"**Parties**" means each Purchaser and each Seller.

"**Permitted Liens**" means (a) statutory liens for current Taxes not yet due and payable, or being contested in good faith by appropriate proceedings, (b) mechanics', carriers', workers', repairers', and other similar liens imposed by law arising or incurred in the ordinary course of business for obligations which are not overdue for a period of more than thirty (30) days or which are being contested in good faith by appropriate proceedings and (c) other liens, charges, easements, restrictions or other encumbrances incidental to the operation of the business or ownership of the Acquired Assets which were not incurred in connection with the borrowing of money or the advance of credit and which, in the aggregate, do not materially detract from the value of the Acquired Assets or materially interfere with the use thereof or the operation of the business in each case taken as a whole.

"**Person**" means any natural person, corporation, general partnership, limited partnership, limited liability company, proprietorship, other business organization, trust, union, association or Governmental Authority.

"**Personal Information**" means individually identifiable information about an employee of Avista Canada, except for the employee's name or business contact information.

"**PST**" means the provincial sales tax payable under the British Columbia Social Service Tax Act.

"**Purchase Price**" has the meaning set forth in Section 2.2.

"**Purchased Taxable Canadian Property**" means any of the Acquired Assets that are considered "taxable Canadian property" within the meaning of subsection 248(1) of the Canada Tax Act and which are listed in Section 3.8 of the Seller Disclosure Schedule.

"**Purchasers**" has the meaning set forth in the introduction to this Agreement.

"**Representatives**" means the officers, employees, counsel, accountants, financial advisers and consultants of any Purchaser or any Seller or their Affiliates.

"**Retained Liabilities**" means all liabilities of Sellers and their Affiliates, other than Assumed Liabilities, including Claims, obligations and Losses under or in connection with (1) the Assigned Contracts transferred from Sellers to Purchasers in accordance with the terms of this Agreement, to the extent such Claims, obligations or Losses arise on or prior to the Effective Time, but not after the Effective Time, (2) all litigation matters in existence as of the Effective Time or which pertain to any matters arising on or before the Effective Time, (3) all accounts payable and (4) all debt, including, without limitation, the Credit Agreement.

"**Returns**" has the meaning set forth in Section 3.14.

"**Risk Policy**" means Sellers' Risk Policy, and related mandates, directives and procedures adopted by each of the Sellers and in effect as of December 31, 2005 through the date of this Agreement, a copy of which is filed in the Data Room.

"**Security Agreement**" means the Security Agreement to be entered into by and among each of the Purchasers and Avista Capital substantially in the form attached hereto as Exhibit M.

"**Seller Disclosure Schedule**" has the meaning set forth in Section 3.

"**Seller Employee Arrangement**" means each Employee Arrangement that is sponsored, maintained, or contributed to by Sellers.

"**Seller Employee Benefit Plan**" means each Employee Benefit Plan that is sponsored, maintained, or contributed to by Sellers.

"**Sellers**" has the meaning set forth in the introduction to this Agreement.

"**Tangible Assets**" has the meaning set forth in Section 2.2.1(b).

"**Taxable Canadian Property Purchase Price**" means the Purchase Price paid in exchange for the Purchased Taxable Canadian Property.

"**Taxes**" means all taxes, charges, fees, levies or other assessments imposed by any United States or Canadian federal, state, province or local or any foreign taxing authority, including income, excise, property, sales, transfer, franchise, payroll, withholding, social security or other taxes, including any interest, penalties, fines or additions attributable thereto or in respect of failure to comply with any requirement concerning Tax returns, other than any taxes for which Avista Energy may be liable solely by reason of being a member of an affiliated, consolidated, combined, unitary or similar tax filing group.

"**Taxing Authority**" has the meaning set forth in Section 3.14.

"**Trade Book**" means the Electronically Recorded Trade Book and the Manually Recorded Commodity Transactions.

"**Transaction Agreements**" means the following agreements:

(a) Jackson Prairie Capacity Release Agreement;

(b) Lancaster Energy Conversion Agreement;

(c) Indemnification Agreement;

(d) Security Agreement and ancillary documents;

(e) Escrow Agreement;

(f) Canadian Withholding Tax Escrow Agreement;

(g) Guaranty;

(h) Agency Agreement;

(i) NOVA/ANG Capacity Assignment;

(j) GTN Capacity Release Agreement; and

(k) Transition Services Agreement.

"**Transfer Taxes**" means all transfer, sales, use, goods and services, value added, documentary, stamp duty, real estate transfer, excise taxes and other similar Taxes, duties or charges including any interest, penalties, fines or additions attributable thereto or in respect of failure to comply with any requirement concerning such Taxes.

"**Transition Services Agreement**" means the Transition Services Agreement to be agreed upon and entered into by Purchasers and Sellers in the form attached hereto as Exhibit N.

"**U.S. Pipelines**" has the meaning set forth in Section 2.4.

"**Western Region**" has the meaning set forth in Section 10.1.1.

**Index of Defined Terms**

**APPENDIX B – SELLER DISCLOSURE SCHEDULE**

**Exhibit G**

Form of Guaranty

**GUARANTY**

This Guaranty Agreement (this "Guaranty") dated effective as of _____, 2007, is entered into by Avista Capital, Inc. ("Guarantor"), a Washington corporation, in favor of Coral Energy Holding, L.P., a Delaware limited partnership, Coral Energy Resources, L.P., a Delaware limited partnership, Coral Power, L.L.C., a Delaware limited liability company and Coral Energy Canada Inc., an Alberta corporation (each being a "Coral Entity" and collectively, the "Coral Entities").

**Recitals:**

A. Guarantor desires that the Coral Entities enter into the contracts and agreements listed on Attachment A hereto with affiliates of Guarantor including Avista Energy, Inc., Avista Energy Canada, Ltd. and Avista Turbine Power, Inc. (each being a "Guaranteed Party" and collectively, the "Guaranteed Parties"), as such contracts and agreements listed on Attachment A may be amended, supplemented, renewed, or extended, collectively, from time to time, the "Contracts"; and

B. The Guaranteed Parties are subsidiaries or affiliates of Guarantor and Guarantor will directly or indirectly benefit from the Contracts to be entered into between one or more of the Coral Entities and one or more of the Guaranteed Parties; and

C. The Guaranteed Parties and the Coral Entities are parties to an Indemnification Agreement of even date herewith with respect to certain obligations between such parties in respect of the Contracts (the "Indemnification Agreement").

NOW, THEREFORE, in consideration of the Coral Entities entering into the Contracts with Guaranteed Parties, Guarantor hereby covenants and agrees as follows:

1. **Guaranty**. Subject to the terms and conditions hereof, Guarantor hereby irrevocably and unconditionally guarantees the timely performance and payment when due of the obligations of Guaranteed Parties (the "Obligations") to the Coral Entities, as applicable, under the Indemnification Agreement with respect to the Contracts. To the extent that a Guaranteed Party shall fail to perform or pay any Obligation, Guarantor shall promptly cause the performance or pay to the applicable Coral Entity the amount due in accordance with the terms, conditions and limitations contained in the Indemnification Agreement. This Guaranty shall constitute a guarantee of payment and not of collection. Guarantor shall also be liable for the reasonable attorneys' fees and expenses of such Coral Entity's external counsel incurred in any successful effort to collect or enforce any of the obligations under this Guaranty.

2. **Limitations**. Guarantor's performance hereunder shall be limited to monetary payments arising out of the Obligations (even if such payments are deemed to be damages) and in no event shall Guarantor be subject hereunder to consequential, exemplary, equitable, loss of profits, punitive, or any other damages, except to the extent specifically provided in the Indemnification Agreement to be due from a Guaranteed Party. Guarantor waives any and all

defenses, rights and benefits Guarantor might assert to avoid or limit liability on Guarantor's obligations arising from the bankruptcy, insolvency, dissolution, or liquidation of Guaranteed Party. The aggregate amount of Guarantor's liability under or in respect of this Guaranty shall in no event exceed Thirty Million Dollars (U.S.$30,000,000), in the aggregate, plus attorney's fees and other expenses specified under Section 1 hereto and shall be calculated by including any amounts paid by any Guaranteed Party under the Indemnification Agreement, or collected on any collateral securing Guarantor's obligations under this Guaranty, against such Thirty Million Dollar cap on Guarantor's liability.

3. **Termination**. This Guaranty shall remain in full force and effect until April 30, 2011. No termination shall affect, release or discharge Guarantor's liability with respect to any Obligations existing or arising prior to the effective date of termination.

4. **Nature of Guaranty**. The Guarantor's obligations hereunder with respect to any Obligation shall not be affected by the existence, validity, enforceability, perfection, release, or impairment of value of any collateral for such Obligations. The Coral Entities shall not be obligated to file any claim relating to the Obligations owing to it in the event that a Guaranteed Party becomes subject to a bankruptcy, reorganization, or similar proceeding, and the failure of a Coral Entity to so file shall not affect the Guarantor's obligations hereunder. In the event that any payment to a Coral Entity in respect of any Obligations is rescinded or must otherwise be returned in the event that a Guaranteed Party becomes subject to a bankruptcy, reorganization, or similar proceeding, Guarantor shall remain liable hereunder in respect to such Obligations as if such payment had not been made.

5. **Subrogation**. Guarantor waives its right to be subrogated to the rights of the Coral Entities with respect to any Obligations paid or performed by Guarantor until all Obligations have been fully and indefeasibly paid to the Coral Entities or otherwise terminated, subject to no rescission or right of return, and Guarantor has fully and indefeasibly satisfied all of Guarantor's obligations under this Guaranty.

6. **Waivers**. Guarantor hereby waives any circumstance which might constitute a legal or equitable discharge of a surety or guarantor, including but not limited to (a) notice of acceptance of this Guaranty; (b) presentment and demand concerning the liabilities of Guarantor; (c) notice of any dishonor or default by, or disputes with, a Guaranteed Party; and (d) any right to require that any action or proceeding be brought against a Guaranteed Party or any other person, or to require that a Coral Entity seek enforcement of any performance against a Guaranteed Party or any other person, prior to any action against Guarantor under the terms hereof. Guarantor consents to the renewal, compromise, extension, acceleration, or other modification of the terms of a Contract, without in any way releasing or discharging Guarantor from its obligations hereunder. Except as to applicable statute of limitations, the time for bringing any claim under the terms of the Indemnification Agreement and duration of this Guaranty as provided in Section 3 above, no delay of a Coral Entity in the exercise of, or failure to exercise, any rights hereunder shall operate as a waiver of such rights, a waiver of any other rights, or a release of Guarantor from any obligations hereunder.

7. **REPRESENTATIONS**. Guarantor is a corporation duly organized and validly existing under the laws of the State of Washington. The execution, delivery and performance of this Guaranty have been duly authorized by all necessary corporate action on the part of Guarantor. This Guaranty constitutes the legal, valid and binding obligation of Guarantor enforceable against Guarantor in accordance with its terms (except that enforcement may be limited by bankruptcy, insolvency, reorganization, or similar laws affecting the enforcement of creditors' rights generally and general principles of equity, whether considered in a proceeding in equity or at law).

8 **Notice**. Any payment demand, notice, correspondence or other document to be given hereunder by any party to another (herein collectively called "Notice") shall be in writing and delivered personally or mailed by certified mail, postage prepaid and return receipt requested, or by facsimile, to the addresses set forth below. Notice given by personal delivery or mail shall be effective upon actual receipt, or, if receipt is refused or rejected, upon attempted delivery. Notice given by facsimile shall be effective upon actual receipt if received during the recipient's normal business hours, or at the beginning of the recipient's next business day after receipt if not received during the recipient's normal business hours. All Notices by facsimile shall be confirmed promptly after transmission in writing by certified mail or personal delivery. Any party may change any address to which Notice is to be given to it by giving Notice as provided above of such change of address.

9. **Miscellaneous**. **THIS GUARANTY SHALL BE IN ALL RESPECTS GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAWS EXCEPT SECTIONS 5-1401 AND 5-1402 OF THE NEW YORK GENERAL OBLIGATIONS LAW.** No term or provision of this Guaranty shall be amended or modified except in a writing signed by Guarantor and each of the Coral Entities. A party may assign its rights and obligations hereunder only with the prior written consent of the Coral Entities, in the case of Guarantor, and Guarantor, in the case of any of the Coral Entities, and any attempted assignment without such prior written consent shall be null and void. Subject to the foregoing, this Guaranty shall be binding upon Guarantor, its successors and assigns, and shall inure to the benefit of and be enforceable by the Coral Entities, their successors and assigns. This Guaranty and the Indemnification Agreement embodies the entire agreement and understanding between Guarantor and the Coral Entities, and supersedes all prior guaranties issued by Guarantor in connection with the Contracts.

IN WITNESS WHEREOF, Guarantor has executed this Guaranty effective as of the date first herein written.

Avista Capital, Inc.

By: _____
Name: _____
Title: _____

Address of: Coral Energy Holding, L.P.
Coral Energy Resources, L.P.
Coral Power, L.L.C.

909 Fannin, Plaza Level 1
Houston, Texas 77010
Attn: Credit Department
Fax No.:

Address of Guarantor: Avista Capital, Inc.

1411 East Mission Avenue
Spokane, Washington 99202
Attn: General Counsel
Fax No.: (509) 495-4361

Address of: Coral Energy Canada Inc.

Coral Energy Canada Inc.
3500, 450-1st Street S.W.
Calgary, Alberta Canada
T2P 5H1
Facsimile: 403-716-3501
Attn: Senior Vice President

**Exhibit H**

Form of Indemnification Agreement

**INDEMNIFICATION AGREEMENT**

THIS INDEMNIFICATION AGREEMENT (this "**Agreement**") is made and entered into as of June __, 2007. The parties to this Agreement (the "**Parties**") are Coral Energy Holding, L.P., a Delaware limited partnership ("**Coral Holding**"), Coral Energy Resources, L.P., a Delaware limited partnership ("**Coral Resources**"), Coral Power, L.L.C., a Delaware limited liability company ("**Coral Power**"), and Coral Energy Canada Inc., a corporation of the province of Alberta, Canada ("**Coral Canada**" and, together with Coral Holding, Coral Resources and Coral Power, each a "**Coral Entity**" and together the "**Coral Entities**," all of which are Affiliates of one another); and Avista Energy, Inc., a Washington corporation ("**Avista Energy**"), Avista Energy Canada, Ltd., an amalgamated corporation of the province of Alberta, Canada ("**Avista Canada**"), and Avista Turbine Power, Inc., a Washington Corporation ("**Avista Turbine**" and, together with Avista Energy and Avista Canada, each an "**Avista Entity**" and together the "**Avista Entities**," all of which are Affiliates of one another). Capitalized terms used and not otherwise defined in this Agreement shall have the meanings given in the Purchase Agreement (defined below).

RECITALS

A. Avista Energy and Avista Canada, as Sellers, are entering into a Purchase and Sale Agreement of even date with the Coral Entities, as Purchasers (the "**Purchase Agreement**"), by which the Coral Entities will purchase substantially all of the operating assets of Avista Energy and Avista Canada.

B. Concurrently with the Parties' entry into this Agreement and as of the Effective Time:

1. Avista Energy, Avista Canada and the Coral Entities are entering into an Agency Agreement (the "**Agency Agreement**") pursuant to which Avista Energy and Avista Canada are appointing certain of the Coral Entities as their agents with respect to certain of the Assigned Contracts;

2. Avista Energy, Avista Canada and the Coral Entities are entering into a Post-Closing Transition Services Agreement (the "**Transition Services Agreement**") pursuant to which Avista Energy and Avista Canada have agreed to provide certain services to the Coral Entities for a limited period of time;

3. Avista Turbine and Coral Power are entering into an Energy Conversion Agreement (the "**Lancaster Agreement**") pursuant to which Coral Power is agreeing to purchase from Avista Turbine the capacity and energy generated from that certain power generation facility located in Rathdrum, Idaho; and

4. Avista Energy and Coral Resources are entering into that certain Agreement to Release Jackson Prairie Storage (the "**JP Agreement**") pursuant to which Coral Resources is obtaining from Avista Energy the right for a limited time to utilize the natural gas storage capacity held by Avista Energy located in Lewis County, Washington.

C. As part of the Purchase Agreement, the Agency Agreement, the Transition Services Agreement, the Lancaster Agreement and the JP Agreement (collectively, with the documents and agreements entered into pursuant to such agreements, the "**Transaction Agreements**"), the Coral Entities and the Avista Entities are entering into this Agreement setting forth the terms and conditions under which the Parties are agreeing to provide indemnification for certain events that may arise out of or relate to the Transaction Agreements.

IN CONSIDERATION of the mutual promises, representations, warranties and covenants set forth in this Agreement, the Parties, each intending to be legally bound, agree as follows:

**1. Definitions. As used in this Agreement:**

(a) "Adverse Consequence" means any and all damages, assessments, charges, penalties, fines, costs, payments, Liabilities, debts, obligations, Taxes, liens, losses, expenses, fees or newly-imposed business restrictions, including court costs and reasonable attorneys' fees and expenses, arising out of or relating to one or more Claims or Orders.

(b) "Claim" means any demand, claim, action, investigation, legal proceeding (whether at law or in equity) or arbitration of any kind whatsoever, whether fixed or contingent.

(c) "Liability" means any liability (whether known or unknown, asserted or unasserted, absolute or contingent, accrued or unaccrued, liquidated or unliquidated, criminal or civil, or due or to become due), including any liability for Taxes.

(d) "Order" means any order, ruling, writ, judgment, injunction, decree, stipulation, determination or award entered by or with any Governmental Authority.

(e) "Third-Party" means any Person (including without limitation Governmental Authorities) other than the Coral Entities and their Affiliates or the Avista Entities and their Affiliates.

2. Indemnification Provisions for Benefit of the Coral Entities. Avista Energy, Avista Canada and, with respect to the Lancaster Agreement only, Avista Turbine, and each of them, jointly and severally, shall indemnify, defend and hold harmless the Coral Entities and each of their Affiliates, successors, officers, directors, employees and agents (each a "Coral Indemnified Party") from and against the entirety of any Adverse Consequences any of them may suffer resulting from, arising out of, relating to, in the nature of, or caused by:

2.1 Breach of Representations and Warranties. Breach by Avista Energy or Avista Canada of one or more of its representations and warranties made in the Purchase Agreement, including, without limitation, any representation or warranty made in:

(a) Sections 3.1, 3.2 or 3.7 of the Purchase Agreement (the "**Title and Authority Representations**");

(b) Sections 3.14 or 3.15 of the Purchase Agreement (the "**Tax Representations**"); or

(c) Section 3.17 of the Purchase Agreement (the "**Environmental Representations**").

2.2 Coral Entity Claims. Claims of any Coral Entity, or Claims against any Coral Entity by Third Parties, resulting from, arising out of, relating to, in the nature of or caused by (a) any breach by (i) an Avista Entity of or default by it under any of its covenants contained in the Purchase Agreement, Agency Agreement or Transition Services Agreement, or (ii) any member of the Avista Group of or default by it under Section 10 of the Purchase Agreement, in each case as such covenants pertain to obligations arising or actions to be taken following the Effective Time, (b) with respect to Third Party Claims only, the ownership or operation of the Acquired Assets on or prior to the Effective Time, or (c) the ownership or operation by of the Excluded Assets or the Retained Liabilities prior to, on or after the Effective Time.

2.3 Claims under Lancaster and JP Agreements. Claims of any Coral Entity resulting from, arising out of, relating to, in the nature of or caused by any breach by an Avista Entity of or default by it under any of its representations, warranties and covenants contained in the Lancaster Agreement or the JP Agreement.

3. Indemnification Provisions for Benefit of the Avista Entities. The Coral Entities and each of them, jointly and severally, shall indemnify, defend and hold harmless the Avista Entities, their Affiliates, successors, officers, directors, employees and agents (each an "Avista Indemnified Party") from and against the entirety of any Adverse Consequences any of them may suffer resulting from, arising out of, relating to, in the nature of, or caused by:

3.1 Breach of Representations and Warranties. Breach by any of the Coral Entities of one or more of its representations and warranties made in the Purchase Agreement. The preceding obligations shall include, without limitation, breach of any representation or warranty made in Section 4.1 or 4.2 (the "Coral Authority Representations") or Section 4.7 (the "Coral Tax Representation") of the Purchase Agreement

3.2 Avista Entity Claims. Claims of any Avista Entity, or Claims against any Avista Entity by Third Parties, resulting from, arising out of, relating to, in the nature of or caused by any breach by a Coral Entity of or default by it under any of its covenants contained in the Purchase Agreement, the Agency Agreement or Transition Services Agreement as such covenants pertain to obligations arising or actions to be taken following the Effective Time, or the ownership or operation of the Acquired Assets and assumption of the Assumed Liabilities by the Coral Entities or their Affiliates after the Effective Time.

3.3 Claims under Lancaster and JP Agreements. Claims of any Avista Entity resulting from, arising out of, relating to, in the nature of or caused by any breach by a Coral Entity of or default by it under any of its representations, warranties and covenants contained in the Lancaster Agreement or the JP Agreement.

4. Claims for Indemnification; Matters Involving Third Parties.

4.1 Notice. If any Coral Indemnified Party or Avista Indemnified Party (the "Indemnified Party") becomes aware of any matter that may give rise to a Claim for indemnification under this Agreement (an "Indemnification Claim") against any of the Avista Entities or Coral Entities, as the case may be (the "Indemnifying Party"), then the Indemnified Party shall give prompt written notice to the Indemnifying Party of each such Claim, stating the nature of such Claim in reasonable detail and indicating the estimated amount, if practicable, of the loss related

thereto. Delay on the part of the Indemnified Party in providing notice shall not relieve the Indemnifying Party from its obligations hereunder unless (and then only to the extent that) the Indemnifying Party is prejudiced or damaged by such delay.

4.2 Acceptance or Rejection. If Indemnifying Party does not accept or affirmatively rejects such Indemnification Claim within thirty (30) days of the date the Indemnified Party provides written notice of the Indemnification Claim to the Indemnifying Party, the Indemnified Party shall be free to seek enforcement of its rights to indemnification under this Agreement. If the Indemnifying Party agrees that it has an indemnification obligation but objects that it is obligated to pay only a lesser amount, the Indemnified Party shall nevertheless be entitled to recover promptly from the Indemnifying Party the lesser amount, without prejudice to the Indemnified Party's Claim for the difference.

4.3 Third Party Claims. If the Indemnification Claim results from a Third-Party Claim or proceeding, the Indemnifying Party will have the right to defend the Indemnified Party against the Third-Party Claim or proceeding with counsel of their choice reasonably satisfactory to the Indemnified Party so long as (i) the Indemnifying Party notifies the Indemnified Party in writing within thirty (30) days after the Indemnified Party has given notice of the Indemnification Claim that the Indemnifying Party will indemnify the Indemnified Party from and against the entirety of any Adverse Consequences, to the fullest extent required under this Agreement, the Indemnified Party may suffer resulting from, arising out of, relating to, in the nature of, or caused by the Indemnification Claim, (ii) the Indemnifying Party provides the Indemnified Party with evidence reasonably acceptable to the Indemnified Party that the Indemnifying Party will have the financial resources to defend against the Indemnification Claim and fulfill its indemnification obligations under this Agreement, and (iii) the Indemnifying Party conducts the defense of the Indemnification Claim actively and diligently.

4.4 Indemnified Party's Rights. So long as the Indemnifying Party is conducting the defense of the Indemnification Claim in accordance with this Agreement, (i) the Indemnified Party may retain separate co-counsel, at its sole cost and expense, and participate in the defense of the Indemnification Claim and (ii) the Indemnified Party will not consent to the entry of any judgment or enter into any settlement with respect to the Indemnification Claim without the prior written consent of the Indemnifying Party which consent will not be unreasonably withheld or delayed.

4.5 Failure to Defend. In the event the Indemnifying Party fails to conduct the defense of an Indemnification Claim that results from a Third-Party Claim or proceeding in accordance with this Agreement, (i) the Indemnified Party may defend against, and consent to the entry of any judgment or enter into any settlement with respect to, the Third-Party Claim or proceeding giving rise to the Indemnification Claim in any manner it may deem appropriate (and the Indemnified Party need not consult with, or obtain any consent from, any Indemnifying Party in connection with the same), (ii) the Indemnifying Party will have the obligation to reimburse the Indemnified Party promptly and periodically for the costs of defending against the Indemnification Claim (including reasonable attorneys' fees and expenses) and (iii) the Indemnifying Party will remain responsible for any Adverse Consequences the Indemnified Party may suffer resulting from, arising out of, relating to, in the nature of, or caused by the Indemnification Claim to the fullest extent provided in this Agreement.

5. Determination of Adverse Consequences. The Parties shall take into account the time value/cost of money (using the Applicable Rate as the discount rate) and also any net Tax benefits/costs in determining Adverse Consequences for purposes of this Agreement.

6. Claims that Related to Periods Both Before and After the Effective Time. The Parties have attempted to allocate their responsibility and indemnification obligations in respect of the Effective Time. To the extent that any Claims otherwise covered by this Agreement relate to both the period on and prior to the Effective Time and the period after the Effective Time, the Indemnification Claim resulting therefrom and the indemnification obligations in respect thereof shall be allocated to the Avista Entities in proportion to the period prior to the Effective Time and to the Coral Entities in proportion to the period after the Effective Time. If the proportion of indemnification obligations cannot be determined between the Parties in good faith, as set forth in this Section 6, such determination shall be submitted to the trier of such Claim which determination shall be final and binding as to the Parties.

7. Limitations on Liability.

7.1 Liability Threshold. Except as provided in the following sentence, and subject to Section 7.3 and 7.4, no Party shall be liable under this Agreement until the aggregate for all Indemnification Claims made by all Coral Indemnified Parties or Avista Indemnified Parties, as the case may be, under this Agreement is in excess of $150,000 and then only for such excess over the $150,000 aggregate threshold. Notwithstanding the foregoing liability threshold, the Avista Entities' indemnification obligations for the Title and Authority Representations, Tax Representations and as set forth in Sections 2.2 and 2.3, above, and the Coral Entities' indemnification obligations for the Coral Authority Representations and Coral Tax Representation and as set forth in Sections 3.2 and 3.3, above, shall be not be subject to such liability threshold limitation, and may be exercised in respect of the "first dollar" of any Indemnification Claim.

7.2 Maximum Liability. Except as provided in the following sentence and Section 7.4, the maximum aggregate liability of the Indemnifying Parties to the Indemnified Parties under this Agreement shall in no event exceed an amount equal to $30,000,000. Notwithstanding the foregoing:

(a) the Avista Entities' indemnification obligations for the Title and Authority Representations and the Coral Entities' indemnification obligations for the Coral Authority Representations shall not exceed the Purchase Price; and

(b) the Avista Entities' indemnification obligations set forth in Section 2.2, above and the Coral Entities' indemnification obligations set forth in Section 3.2, above, shall be unlimited in dollar amount.

7.3 Survival of Indemnification Rights. An Indemnification Claim under this Agreement must be made, if at all, prior to the expiration of the following time periods:

(a) In the case of Indemnification Claims under Section 2.2 and Section 3.2 for which a performance period is specified, the duration of such performance period;

(b) In the case of Indemnification Claims under Section 2.2 and 3.2 other than as set forth in Section 7.3(a) above, there shall be no expiration period under this Agreement;

(c) In the case of Indemnification Claims under Section 2.1 or 3.1, other than as set forth in Section 7.3(d) below, such Indemnification Claim must be made no later than 18 months after the Effective Time;

(d) In the case of Indemnification Claims with respect to any of the Title and Authority, Tax, Environmental and Coral Authority Representations and Coral Tax Representations, such Indemnification Claim must be made no later than the third (3rd) anniversary of the Effective Time; and

(e) In the case of Indemnification Claims under Section 2.3 and Section 3.3, such Indemnification Claim must be made no later than thirty (30) days following the term of such agreement.

Indemnification Claims shall be barred if not made prior to the above expiration dates, and all obligations of indemnification with respect to such Indemnification Claims shall terminate and be of no further force or effect if such Indemnification Claims are not made prior to such dates.

7.4 Certain Breaches Not Subject to Limitations. Claims for indemnification with respect to (i) fraud or (ii) intentional misrepresentation shall not be subject to any of the limitations set forth in Section 7.1, Section 7.2, Section 7.3, Section 8 or Section 9.

8. Exclusive Remedy. The rights of the Avista Entities and the Coral Entities to assert Indemnification Claims and to receive indemnification payments pursuant to this Agreement shall be their sole and exclusive right and remedy with respect to any breach by any other party of any representation, warranty or covenant contained in the Transaction Agreements, except for the rights provided to the Parties to seek injunctions to prevent breaches of the Transaction Agreements or to enforce specifically the Transaction Agreements, as provided therein, and in all cases subject to the limitations on liability established in this Agreement.

9. Consequential Damages Limitation. Except as provided in the following sentence, in no event shall any Party have any obligation or liability arising under or relating to the Transaction Agreements (or any other agreement, document or certificate delivered in connection with the transactions contemplated by the Transaction Agreements) or this Agreement for any consequential, punitive, special or indirect loss or damage, including lost profits or lost opportunities, and each Party hereby expressly releases the other Parties from the same. As between the Parties to this Agreement, Claims for indemnification with respect to Third-Party Claims under this Agreement shall not be subject to the limitations set forth in the previous sentence to the extent of such Claims by Third-Parties, but the Parties acknowledge and agree that nothing contained in this Agreement is intended to, nor shall be construed to, waive, modify, amend or release any independent waiver of such consequential damages as may exist with respect to such Third-Party Claims outside of this Agreement or create a right for any person to recover consequential damages.

10. Miscellaneous.

10.1 Reliance. Each of the Coral Entities and the Avista Entities expressly confirms and agrees that it has entered into this Agreement and assumes the obligations imposed on it hereby in order to induce the other Parties to enter into the Transaction Agreements, and each of the Coral Entities and each of the Avista Entities acknowledges that the other Parties are relying upon this Agreement in entering into the Transaction Agreements.

10.2 Entire Agreement. This Agreement, the Transaction Agreements (including the documents referred to therein) and the Guaranty, the Security Agreement and the Escrow Agreement constitutes the entire agreement between the Parties hereto with respect to the subject matter hereof and supersedes any prior understandings, agreements or representations by or among the Parties, written or oral, to the extent they related in any way to the subject matter of this Agreement and the Transaction Agreements.

10.3 Succession and Assignment. This Agreement shall be binding upon and inure to the benefit of the Parties named in this Agreement and their respective successors and permitted assigns. Except as provided in the next sentence, no party may assign either this Agreement or any of its rights, interests or obligations under this Agreement without the prior written approval of the other Parties. The Coral Entities and the Avista Entities shall be entitled to assign this Agreement and any and all of their rights and interests under it to any Affiliate without the prior written approval of the other Parties, but such an assignment shall not relieve, discharge or otherwise affect the duties and obligations of the assigning Party under this Agreement, all of which shall remain in full force and effect.

10.4 Counterparts. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original but all of which together will constitute one and the same instrument.

10.5 Headings. The Section headings contained in this Agreement are inserted for convenience only and shall not affect in any way the meaning or interpretation of this Agreement.

10.6 Notices. All notices, Indemnification Claims and other communications under this Agreement will be in writing. Any notice, Indemnification Claim or other communication under this Agreement shall be deemed duly given if it is sent to the intended recipient as set forth below:

If to the Avista Entities to:

Avista Energy, Inc.
c/o Avista Corporation
1411 East Mission Avenue
Spokane, Washington 99202
Facsimile: (509) 495-4361
Attn.: General Counsel

With copies to:

Avista Capital, Inc.
1411 East Mission Avenue
Spokane, Washington 99202
Facsimile: (509) 495-4361
Attn.: General Counsel

and to:

Heller Ehrman LLP
701 Fifth Avenue, Suite 6100
Seattle, Washington 98104
Facsimile: (206) 447-0849
Attn.: Bruce M. Pym

If to the Coral Entities to:

Coral Energy Holding, L.P.
Coral Energy Resources, L.P.
Coral Power, L.L.C.
909 Fannin, Plaza, Level 1
Houston, Texas 77010
Facsimile: (713) 767-5699
Attn.: Senior Vice President

Coral Energy Canada Inc.
3500, 450 - 1st Street S.W.
Calgary, Alberta
T2P 5H1
Facsimile: 403-716-3501
Attn: Senior Vice President

With copies to:

Coral Energy Holding, L.P.
909 Fannin Street, Level 1
Houston, Texas 77010
Facsimile: (713) 767-5699
Attn.: General Counsel

Any party may send any notice, Indemnification Claim or other communication under this Agreement to the intended recipient at the address set forth above using personal delivery, expedited or overnight courier, messenger service, facsimile or ordinary mail, but no such notice, Indemnification Claim or other communication shall be deemed to have been duly given unless and until it actually is received by or at the address or number of the intended recipient as specified in this Section 10.6. Any party may change the address to which notices, Indemnification Claims and other communications under this Agreement are to be delivered by giving the other Parties notice in the manner set forth in this Agreement.

10.7 Governing Law. This Agreement shall be governed by and construed in accordance with the domestic laws of the State of New York without giving effect to any choice or conflict of law provision or rule (whether under 5-1401 and 5-1402 of the New York General Obligations Law or any other jurisdiction) that would cause the application of the laws of any jurisdiction other than the State of New York.

10.8 Amendments and Waivers. No amendment of any provision of this Agreement shall be valid unless the same shall be in writing and signed by the Avista Entities and the Coral Entities. No waiver by any party of any default under this Agreement, whether intentional or not, shall be deemed to extend to any prior or subsequent default under this Agreement or affect in any way any rights arising by virtue of any prior or subsequent such occurrence.

10.9 Severability. Any term or provision of this Agreement that is invalid or unenforceable in any situation in any jurisdiction shall not affect the validity or enforceability of the remaining terms and provisions of this Agreement or the validity or enforceability of the offending term or provision in any other situation or in any other jurisdiction. Without limiting the

generality of the foregoing, this Agreement is intended to confer upon the Parties indemnification rights to the fullest extent permitted by applicable laws. In the event any provision hereof conflicts with any applicable law, such provision shall be deemed modified, consistent with the aforementioned intent, to the extent necessary to resolve such conflict.

10.10 Construction. The Parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the Parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The words “includes” and “including” shall not be words of limitation. The Parties intend that each covenant contained in this Agreement shall have independent significance. If any party has breached any covenant contained in this Agreement in any respect, the fact that there exists another covenant relating to the same subject matter (regardless of the relative levels of specificity) that the party has not breached shall not detract from or mitigate the fact that the party is in breach of the first covenant.

10.11 Interpretation and Construction. In interpreting and construing this Agreement, the following principles shall be followed:

(a) examples shall not be construed to limit, expressly or by implication, the matter they illustrate;

(b) the terms “herein,” “hereof,” “hereby,” and “hereunder,” or other similar terms, refer to this Agreement as a whole and not only to the particular article, section or other subdivision in which any such terms may be employed;

(c) references to sections and other subdivisions refer to the sections and other subdivisions of this Agreement;

(d) no consideration shall be given to the captions of the sections, subsections, or clauses, which are inserted for convenience in locating the provisions of this Agreement and not as an aid in its construction;

(e) the word “includes” and its syntactical variants mean “includes, but is not limited to” and corresponding syntactical variant expressions and the term “and/or” shall mean “or”;

(f) currency amounts referenced herein, unless otherwise specified, are in U.S. Dollars;

(g) whenever this Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified;

(h) the plural shall be deemed to include the singular, and vice versa; and

(i) each exhibit, attachment, and schedule to this Agreement is a part of this Agreement, but if there is any conflict or inconsistency between the main body of this Agreement and any exhibit, attachment, or schedule, the provisions of the main body of this Agreement shall prevail.

EXECUTED effective as of the date first above written.

**CORAL ENTITIES**

CORAL ENERGY HOLDING, L.P.

By: _____
Name: _____
Title: _____

CORAL ENERGY RESOURCES, L.P.

By: _____
Name: _____
Title: _____

CORAL POWER, L.L.C.

By: _____
Name: _____
Title: _____

CORAL ENERGY CANADA INC.

By: _____
Name: _____
Title: _____

**AVISTA ENTITIES**

AVISTA ENERGY, INC.

By: _____
Name: _____
Title: _____

AVISTA ENERGY CANADA, LTD.

By: _____
Name: _____
Title: _____

AVISTA TURBINE POWER, INC.

By: _____
Name: _____
Title: _____

**Exhibit M**

Form of Security Agreement

**SECURITY AGREEMENT**

This SECURITY AGREEMENT dated as of _____, 2007 (this "Security Agreement") is given by **Avista Capital, Inc.**, a Washington corporation ("Debtor"), in favor of **Coral Energy Holding, L.P.**, a Delaware limited partnership ("Coral"), for the benefit of Coral, **Coral Energy Resources, L.P.**, a Delaware limited partnership, **Coral Power, L.L.C.**, a Delaware limited liability company and **Coral Energy Canada Inc.**, an Alberta corporation (collectively, the "Coral Entities").

RECITALS

**A.** Pursuant to that certain Guaranty dated _____, __, 2007, Debtor has agreed to guaranty certain Obligations of its affiliates, Avista Energy, Inc., Avista Energy Canada Ltd. and Avista Turbine Power, Inc. to the Coral Entities (the "Guaranty").

**B.** Debtor has agreed to grant to Coral for the benefit of the Coral Entities a security interest in certain of its property as provided herein.

**C.** Coral has agreed to act as agent for and on behalf of the Coral Entities for purposes of this Security Agreement.

AGREEMENT

For and in consideration of the promises and the agreements contained in this Agreement and for other good and valuable consideration, the receipt and sufficient of which are hereby acknowledged, the parties agree as follows:

1. Definitions. Capitalized terms used and not otherwise defined herein shall have the meanings ascribed to them as set forth in **Appendix A** attached to and made a part of this Security Agreement. In the absence of such definitions, any other terms used herein (whether or not capitalized) shall have the meaning ascribed to them by the Code to the extent the same are defined in the Code.

2. Grant of Security Interest. Debtor hereby grants to Coral for the benefit of the Coral Entities a first priority security interest in the Collateral to secure the Obligations including, without limitation:

   2.1. the prompt and complete payment of all Obligations;

   2.2. the timely performance and observance by Debtor of all covenants, obligations and conditions contained in the Guaranty; and

   2.3. without limiting the generality of the foregoing and to the fullest extent permitted under applicable law, the payment of all amounts, including without limitation, interest which constitutes part of the Obligations and would be owed by Debtor to one or more of the Coral Entities under the Guaranty but for the fact that they are unenforceable or not allowable due to the existence of a bankruptcy, reorganization or similar proceeding involving Debtor

   and Debtor hereby agrees to deliver the Collateral to the Escrow Agent under the Escrow Agreement, to be held by the Escrow Agent as the Escrow Fund under the Escrow Agreement, for the benefit of the Coral Entities. Provided, however, that under no circumstances shall the aggregate of all such obligations secured by this Security Agreement, including the Obligations and any other amounts referred to above, exceed at any time an aggregate value of Twenty-Five Million Dollars ($25,000,000.00).

3. Substitute Collateral. Debtor shall be entitled at any time, and from time to time, to substitute any of the following, in form and substance reasonably acceptable to Coral, as substitute

collateral for the Collateral: (a) a cash deposit in an amount equal to Twenty-Five Million Dollars ($25,000,000.00); (b) an irrevocable letter of credit in a face amount equal to Twenty-Five Million Dollars ($25,000,000.00), issued by a U.S. commercial bank or the U.S. branch of a foreign bank, with such bank having a credit rating of at least A- from the Standard & Poor's Rating Group (a division of McGraw-Hill, Inc.) or its successor, or a rating of at least A3 from Moody's Investor Services, Inc. or its successor, or (c) such other form of collateral security as Coral and Debtor may mutually agree upon. Upon completion of any such substitution of collateral, the substitute collateral shall become the "Collateral" hereunder, and Coral shall release, return, surrender, and otherwise terminate any security interest granted hereunder in, the property or instruments previous serving as "Collateral" hereunder.

4. Authorization to File Financing Statements. Debtor authorizes Coral to file with the Department of Licensing for the State of Washington an initial financing statement and continuation statements that (a) indicate the Collateral; and (b) provide any other information required by part 5 of Article 9 of the Code or as required by such other jurisdiction for the sufficiency or filing office acceptance of such financing statement or continuation statement, including whether Debtor is an organization, the type of organization and any organization identification number issued to Debtor. Debtor agrees to furnish any such information to Coral promptly upon the request.

5. Covenants Concerning Debtor's Legal Status. Debtor covenants with Coral as follows:

   5.1. Without providing at least 30 days prior written notice to Coral, Debtor will not change its name, its place of business or, if more than one, chief executive office, or its mailing address or organizational identification number if it has one;

   5.2. If Debtor does not have an organizational identification number and later obtains one, Debtor will promptly notify Coral of such organizational identification number; and

   5.3. Without providing at least 30 days prior written notice to Coral, Debtor will not change its type of organization, jurisdiction of organization or other legal structure.

6. Representations and Warranties Concerning Collateral. Debtor further represents and warrants to Coral as follows:

   6.1. Except for the security interests granted to Coral in this Agreement, Debtor owns good and marketable title to the Collateral free and clear of all Liens, and neither the Collateral nor any interest in the Collateral has been transferred to any other party. Debtor has full right, power and authority to grant a first-priority security interest in the Collateral to Coral in the manner provided in this Security Agreement, free and clear of any other Liens, adverse claims and options and without the consent of any other person or entity or if consent is required, such consent has been obtained. No other Lien, adverse claim or option has been created by Debtor or is known by Debtor to exist with respect to any Collateral; and to the best of Debtor's knowledge and belief no financing statement or other security instrument is on file in any jurisdiction covering such Collateral other than the security interest in favor of Coral under this Security Agreement. The security interest granted is a first lien security interest.

   6.2. There are no actions, suits or proceedings pending or threatened against or affecting the Collateral before any court or by or before any governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which in any manner draws into question the validity of this Security Agreement.

7. Covenants Concerning the Collateral.

   7.1. Debtor covenants with Coral that while this Security Agreement remains in effect, that except for the security interest herein granted and the deposit of the Collateral with the Escrow Agent

under the Escrow Agreement, Debtor is and shall be the owner of or have other transferable rights in the Collateral free from any right or claim of any other person or any Lien, security interest or other encumbrance, and Debtor shall defend the same against all claims and demands of all persons at any time claiming the same or any interest therein adverse to Coral. Debtor shall not pledge, mortgage or create, or suffer to exist any right of any person in or claim by any person to the Collateral, or any security interest, Lien or other encumbrance in the Collateral in favor of any person other than Coral; nor permit any person, other than Coral, to file any financing statement or security interest in the Collateral.

7.2. In the event of (a) a sale, transfer, disposition or reorganization of greater than 50% of the equity of Debtor's subsidiary, Advantage IQ, Inc, a Washington corporation ("Advantage"), (b) Debtor ceasing to own and control shares of stock of and other equity interests in Advantage representing a majority of the votes entitled to be cast by shareholders of Advantage and a majority of the equity value of Advantage, or (c) the sale, transfer or other disposition of the underlying assets of Advantage outside the ordinary course of business, Debtor agrees to replace the Collateral with substitute Collateral as set forth Section 3.

8. Securities and Deposits. Coral may at any time following and during the continuance of an Event of Default, at its option, transfer to itself or any nominee any securities constituting Collateral, receive any income thereon and hold such income as additional Collateral or apply it to the Obligations. Whether or not any Obligations are due, Coral may following and during the continuance of an Event of Default demand, sue for, collect or make any settlement or compromise that it deems desirable with respect to the Collateral.

9. Rights and Remedies. If an Event of Default shall have occurred and is continuing, Coral shall have in any jurisdiction in which enforcement hereof is sought, in addition to all other rights and remedies, the rights and remedies of a secured party under the Code and any additional rights and remedies as may be provided to a secured party in any jurisdiction in which Collateral is located, including, without limitation, the right to take possession of the Collateral.

10. No Waiver by Coral. Coral shall not be deemed to have waived any of its rights and remedies in respect of the Obligations or the Collateral unless such waiver shall be made in writing and signed by Coral. No delay or omission on the part of Coral in exercising any right or remedy shall operate as a waiver of such right or remedy or any other right or remedy. A waiver on any occasion shall not be construed as a bar to or a waiver of any right or remedy on any future occasion. All rights and remedies of Coral with respect to the Obligations or the Collateral, whether evidenced hereby or by any other instrument or papers, may be exercised by Coral, shall be cumulative and may be exercised singularly, alternatively, successively or concurrently at such time or at such times as Coral deems expedient.

11. Marshalling. Subject to the terms and conditions of this Security Agreement and the Indemnification Agreement, Coral shall not be required to marshal the Collateral, or other assurances of payment of the Obligations, or any of them or to resort to the Collateral or other assurance of payment in any particular order, and all of the rights and remedies hereunder and in respect of the Collateral and other assurances of payment shall be cumulative and in addition to all other rights and remedies, however existing or arising. **TO THE EXTENT THAT IT LAWFULLY MAY, DEBTOR HEREBY AGREES THAT IT WILL NOT INVOKE ANY LAW RELATING TO THE MARSHALLING OF COLLATERAL WHICH MIGHT CAUSE DELAY IN OR IMPEDE THE ENFORCEMENT OF CORAL'S RIGHTS AND REMEDIES UNDER THIS SECURITY AGREEMENT OR UNDER ANY OTHER INSTRUMENT CREATING OR EVIDENCING ANY OF THE OBLIGATIONS OR UNDER WHICH ANY OF THE OBLIGATIONS IS OUTSTANDING OR BY WHICH ANY OF THE OBLIGATIONS IS SECURED OR PAYMENT THEREOF IS OTHERWISE ASSURED, AND, TO THE EXTENT THAT IT LAWFULLY MAY, DEBTOR HEREBY IRREVOCABLY WAIVES THE BENEFITS OF ALL SUCH LAWS.**

12. Overdue Amounts. Until paid, all amounts due and payable by Debtor hereunder shall be a debt secured by the Collateral and shall bear, whether before or after judgment, interest determined by reference to the U.S. Dollar London Interbank Offer Rate (LIBOR) quoted on Bloomberg page BBAM applicable for the relevant one-month period (or any successor or substitute page of such publication, or any successor to or substitute for such publication, providing rate quotations comparable to those currently provided on such page or such publication) at approximately 11:00 a.m., London time, two Business Days prior to the commencement of such interest period.

13. Notices. All communications hereunder shall be in writing and may be delivered by hand delivery, United States mail, overnight courier service or facsimile. Notice by facsimile or hand delivery shall be effective on the day actually received, if received during business hours on a Business Day, and otherwise shall be effective at the beginning of the recipient's next Business Day. Notice by overnight United States mail or courier shall be effective on the next Business Day after it was sent to the appropriate notice address set forth below or at such other address as any party hereto may have furnished to the other party in writing:

If to the Coral Entities:

909 Fannin, Plaza Level 1
Houston, Texas 77010
Attn: General Counsel
Phone: (713) 767-5400
Fax: (713) 230-2900

If to Debtor:

Avista Capital, Inc.
1411 East Mission Avenue
Spokane, Washington 99202
Attention: General Counsel
Phone: (509) 495-8687
Facsimile: (509) 495-4316

14. Governing Law; Consent to Jurisdiction. **THIS SECURITY AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK, WITHOUT REFERENCE TO ITS CONFLICT OF LAWS PROVISIONS EXCEPT SECTIONS 5-1401 AND 5-1402 OF THE NEW YORK GENERAL OBLIGATIONS LAW**.

15. Term of Agreement. This grant of a security interest under this Security Agreement shall remain in full force until the later of January 1, 2009 or, in the event that any of the Coral Entities has made a claim under the Indemnification Agreement, the date such claim has been resolved and such amount owing, if any, has been paid. Upon expiration of this Security Agreement, Coral shall promptly return possession of the Collateral, if it then has possession of the same, to Debtor and file any applicable termination statements. Notwithstanding the foregoing, this Security Agreement shall continue notwithstanding the reorganization or bankruptcy of Debtor, or any other similar event or proceeding affecting Debtor.

16. Miscellaneous. The headings of each section of this Security Agreement are for convenience only and shall not define or limit the provisions thereof. This Security Agreement and all rights and obligations hereunder shall be binding upon Debtor and its successors and assigns and shall insure to

the benefit of the Coral Entities and their successors and assigns. No party may assign its interest in this Security Agreement without the prior written consent of Coral, in the case of Debtor, and Debtor, in the case of the Coral Entities. If any term of this Security Agreement shall be held to be invalid, illegal or unenforceable, the validity of all of the other terms shall in no way be affected and this Security Agreement shall be construed and enforceable as if such invalid, illegal or unenforceable term had not be included herein. This Security Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

17. Interpretation and Construction. In interpreting and construing this Security Agreement, the following principles shall be followed:

17.1. examples shall not be construed to limit, expressly or by implication, the matter they illustrate;

17.2. the terms “herein,” “hereof,” “hereby,” and “hereunder,” or other similar terms, refer to this Security Agreement as a whole and not only to the particular article, section or other subdivision in which any such terms may be employed;

17.3. references to sections and other subdivisions refer to the sections and other subdivisions of this Security Agreement;

17.4. the word “includes” and its syntactical variants mean “includes, but is not limited to” and corresponding syntactical variant expressions and the term “and/or” shall mean “or”;

17.5. whenever this Security Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified;

17.6. the plural shall be deemed to include the singular, and vice versa; and

17.7. each exhibit, annex, attachment, and schedule to this Security Agreement is a part of this Security Agreement, but if there is any conflict or inconsistency between the main body of this Security Agreement and any exhibit, annex, attachment, or schedule, the provisions of the main body of this Security Agreement shall prevail.

*****

IN WITNESS WHEREOF, intending to be legally bound, Debtor has caused this Security Agreement to be executed as of the date first written above.

***

**Avista Capital, Inc.**

BY: _____
NAME: _____
TITLE: _____

**Coral Energy Holding, L.P.**

BY: _____
NAME: _____
TITLE: _____

**APPENDIX A TO SECURITY AGREEMENT**

**DEFINITIONS**

"Business Day" means any day other than a Saturday, Sunday or any day in which commercial banks in Houston, Texas are required or permitted by law to be closed and the Friday following the Thanksgiving holiday.

"Code" means the Uniform Commercial Code as currently in effect and as may be amended from time to time, in the State of New York.

"Collateral" means 13,770,285 of shares of common stock of Advantage (defined and described in Section 7.2 of this Security Agreement), which represents with respect to Advantage (a) 49.96% of its common stock and 46.53% of all of its equity interests, on an as-converted basis, currently outstanding, and (b) 38.68% of all of its equity interests calculated on an as-converted and fully diluted basis, in each case as measured by vote and value.

"Coral" has the meaning ascribed to it in the preface.

"Coral Entities" has the meaning ascribed to it in the preface.

"Debtor" has the meaning ascribed to it in the preface.

"Escrow Agreement" means that certain Escrow Agreement of even date herewith entered into by and among Coral, Debtor and Avista Corporation, as escrow agent (the "Escrow Agent"), for the purposes of establishing an escrow fund (the "Escrow Fund") consisting of the Collateral.

"Event of Default" means:

a. Any default or event of default under the Guaranty;

b. Any representation or warranty made by Debtor herein is false or misleading in any material respect when made;

c. Debtor's failure to comply with any of the provisions of this Security Agreement and such failure remains unremedied for three (3) Business Days after written notice thereof has been given to Debtor;

d. The transfer or disposition of any of the Collateral, except as expressly permitted by this Security Agreement;

e. The attachment, execution or levy on any of the Collateral, except as expressly permitted by this Security Agreement;

f. Debtor voluntarily or involuntarily becomes subject to any proceeding under any bankruptcy or insolvency statute; or

g. Debtor fails to comply with or becomes subject to any administrative or judicial proceeding under any federal, state or local (a) asset forfeiture or similar law which can result in the forfeiture of property; or (b) other law, where noncompliance may have any significant effect on the Collateral.

"Indemnification Agreement" means that certain Indemnification Agreement of even date herewith entered into by and among Avista Energy, Inc., Avista Energy Canada, Ltd., Avista Turbine Power, Inc. and the Coral Entities.

"Lien" means any mortgage, pledge, security interest, encumbrance, lien, claim or charge of any kind, whether or not filed, recorded or otherwise perfected under applicable law.

"Obligations" means all of the indebtedness, obligations and liabilities of Debtor to the Coral Entities arising or accruing under the Guaranty.

"Security Agreement" has the meaning ascribed to it in the preface.

**EXHIBIT 12**

AVISTA CORPORATION

Computation of Ratio of Earnings to Fixed Charges and Preferred Dividend Requirements
Consolidated
(Thousands of Dollars)

| | 12 months ended March 31, 2007 | Years Ended December 31 | | | |
|---|---|---|---|---|---|
| | | 2006 | 2005 | 2004 | 2003 |
| Fixed charges, as defined: | | | | | |
| Interest expense | $ 87,073 | $ 88,426 | $ 84,952 | $ 84,746 | $ 85,013 |
| Amortization of debt expense and premium—net | 7,528 | 7,741 | 7,762 | 8,301 | 7,972 |
| Interest portion of rentals | 1,744 | 1,802 | 2,394 | 2,443 | 4,452 |
| Total fixed charges | $ 96,345 | $ 97,969 | $ 95,108 | $ 95,490 | $ 97,437 |
| Earnings, as defined: | | | | | |
| Income from continuing operations | $ 55,655 | $ 73,133 | $ 45,168 | $ 35,614 | $ 50,643 |
| Add (deduct): | | | | | |
| Income tax expense | 31,060 | 42,090 | 25,861 | 21,592 | 35,340 |
| Total fixed charges above | 96,345 | 97,969 | 95,108 | 95,490 | 97,437 |
| Total earnings | $ 183,060 | $ 213,192 | $ 166,137 | $ 152,696 | $ 183,420 |
| Ratio of earnings to fixed charges | 1.90 | 2.18 | 1.75 | 1.60 | 1.88 |
| Fixed charges and preferred dividend requirements: | | | | | |
| Fixed charges above | $ 96,345 | $ 97,969 | $ 95,108 | $ 95,490 | $ 97,437 |
| Preferred dividend requirements (1) | — | — | — | — | 1,910 |
| Total | $ 96,345 | $ 97,969 | $ 95,108 | $ 95,490 | $ 99,347 |
| Ratio of earnings to fixed charges and preferred dividend requirements | 1.90 | 2.18 | 1.75 | 1.60 | 1.85 |

(1) Preferred dividend requirements have been grossed up to their pre-tax level. Effective July 1, 2003, preferred dividends are included in interest expense with the adoption of SFAS No. 150.

**Exhibit 15**

May 4, 2007

Avista Corporation
Spokane, Washington

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of Avista Corporation and subsidiaries for the periods ended March 31, 2007 and 2006, as indicated in our report dated May 3, 2007; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, is incorporated by reference in Registration Statement Nos. 2-81697, 2-94816, 033-54791, 333-03601, 333-22373, 333-58197, 033-32148, 333-33790, 333-47290, and 333-126577 on Form S-8, in Registration Statement Nos. 333-106491, 033-53655, 333-39551, 333-82165, 333-63243, 333-16353, 333-16353-01, 333-16353-02, 333-16353-03, 333-64652, 033-60136, 333-10040, 333-113501, and 333-139239 on Form S-3, and in Registration Statement Nos. 333-62232 and 333-82502 on Form S-4, and in AVA Formation Corp.'s Registration Statement No. 333-131872 on Form S-4.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ Deloitte & Touche LLP

Seattle, Washington

**Exhibit 31.1**

**CERTIFICATION**

I, Gary G. Ely, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Avista Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2007

/s/ Gary G. Ely

Gary G. Ely
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

**Exhibit 31.2**

**CERTIFICATION**

I, Malyn K. Malquist, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Avista Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 4, 2007

/s/ Malyn K. Malquist

Malyn K. Malquist
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

**Exhibit 32**

# AVISTA CORPORATION

## CERTIFICATION OF CORPORATE OFFICERS

(Furnished Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002)

Each of the undersigned, Gary G. Ely, Chairman of the Board and Chief Executive Officer of Avista Corporation (the "Company"), and Malyn K. Malquist, Executive Vice President and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and that the information contained therein fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 4, 2007

/s/ Gary G. Ely
Gary G. Ely
Chairman of the Board and Chief Executive Officer

/s/ Malyn K. Malquist
Malyn K. Malquist
Executive Vice President and Chief Financial Officer