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 June 30, 2005

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Yes ☒ No ☐

As of August 1, 2005, 48,532,899 shares of Registrant's Common Stock, no par value (the only class of common stock), were outstanding.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements, which should be read with the cautionary statements and important factors included in this Quarterly Report on Form 10-Q at "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations—Forward-Looking Statements." Forward-looking statements are all statements other than statements of historical fact, including, without limitation, those that are identified by the use of words such as, but not limited to, "will," "may," "could," "should," "intends," "plans," "seeks," "anticipates," "estimates," "expects," "projects," "predicts," and similar expressions. Such statements are subject to a variety of risks, uncertainties and other factors, most of which are beyond the control of Avista Corporation and many of which could have a significant impact on Avista Corporation's operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements.

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CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
Avista Corporation
For the Three Months Ended June 30
Dollars in thousands, except per share amounts

	2005	2004
OPERATING REVENUES	$272,832	$225,888
OPERATING EXPENSES:		
Resource costs	130,975	95,496
Operations and maintenance	33,316	33,276
Administrative and general	25,079	24,769
Depreciation and amortization	21,388	20,631
Taxes other than income taxes	16,064	15,129
Total operating expenses	226,822	189,301
GAIN ON SALE OF NATURAL GAS DISTRIBUTION PROPERTIES	3,209	—
INCOME FROM OPERATIONS	49,219	36,587
OTHER INCOME (EXPENSE):		
Interest expense	(21,312)	(21,952)
Interest expense to affiliated trusts	(1,516)	(1,607)
Capitalized interest	295	396
Net interest expense	(22,533)	(23,163)
Other income - net	1,840	2,716
Total other income (expense)-net	(20,693)	(20,447)
INCOME BEFORE INCOME TAXES	28,526	16,140
INCOME TAXES	9,922	6,008
NET INCOME	$ 18,604	$ 10,132
Weighted-average common shares outstanding (thousands), Basic	48,508	48,384
Weighted-average common shares outstanding (thousands), Diluted	48,904	48,881
EARNINGS PER COMMON SHARE, BASIC AND DILUTED (Note 10):	$ 0.38	$ 0.21
Dividends paid per common share	$ 0.135	$ 0.130

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
Avista Corporation
For the Six Months Ended June 30
Dollars in thousands, except per share amounts

	2005	2004
OPERATING REVENUES	$635,496	$569,620
OPERATING EXPENSES:		
Resource costs	353,132	298,761
Operations and maintenance	68,046	67,019
Administrative and general	49,334	50,265
Depreciation and amortization	44,094	38,313
Taxes other than income taxes	36,697	35,468
Total operating expenses	551,303	489,826
GAIN ON SALE OF NATURAL GAS DISTRIBUTION PROPERTIES	3,209	—
INCOME FROM OPERATIONS	87,402	79,794
OTHER INCOME (EXPENSE):		
Interest expense	(43,140)	(44,103)
Interest expense to affiliated trusts	(2,966)	(3,085)
Capitalized interest	587	976
Net interest expense	(45,519)	(46,212)
Other income - net	3,662	4,372
Total other income (expense)-net	(41,857)	(41,840)
INCOME BEFORE INCOME TAXES	45,545	37,954
INCOME TAXES	16,752	15,138
NET INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	28,793	22,816
CUMULATIVE EFFECT OF ACCOUNTING CHANGE (net of tax)	—	(460)
NET INCOME	$ 28,793	$ 22,356
Weighted-average common shares outstanding (thousands), Basic	48,493	48,368
Weighted-average common shares outstanding (thousands), Diluted	48,893	48,883
EARNINGS PER COMMON SHARE, BASIC AND DILUTED (Note 10):		
Earnings per common share before cumulative effect of accounting change	$ 0.59	$ 0.47
Loss per common share from cumulative effect of accounting change	—	(0.01)
Total earnings per common share, basic and diluted	$ 0.59	$ 0.46
Dividends paid per common share	$ 0.270	$ 0.255

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
Avista Corporation
Dollars in thousands

For the Three Months Ended June 30

	2005	2004
NET INCOME	$18,604	$10,132
OTHER COMPREHENSIVE INCOME (LOSS):		
Foreign currency translation adjustment	(84)	(125)
Unrealized losses on interest rate swap agreements - net of taxes of $(3,551) and $(20), respectively	(6,595)	(37)
Unrealized losses on securities available for sale - net of taxes of $(85)	(157)	—
Unrealized gains on derivative commodity instruments - net of taxes of $1,678 and $97, respectively	3,117	180
Reclassification adjustment for realized gains on derivative commodity instruments included in net income - net of taxes of $(22) and $(5), respectively	(40)	(10)
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	(3,759)	8
COMPREHENSIVE INCOME	$14,845	$10,140

For the Six Months Ended June 30

	2005	2004
NET INCOME	$28,793	$22,356
OTHER COMPREHENSIVE INCOME (LOSS):		
Foreign currency translation adjustment	(113)	(197)
Unrealized gains (losses) on interest rate swap agreements - net of taxes of $(3,299) and $82, respectively	(6,127)	152
Unrealized losses on securities available for sale - net of taxes of $(85)	(157)	—
Unrealized gains (losses) on derivative commodity instruments - net of taxes of $916 and $(667), respectively	1,702	(1,239)
Reclassification adjustment for realized (gains) losses on derivative commodity instruments included in net income - net of taxes of $(227) and $27, respectively	(422)	49
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	(5,117)	(1,235)
COMPREHENSIVE INCOME	$23,676	$21,121

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED BALANCE SHEETS
(Unaudited)
Avista Corporation
Dollars in thousands

	June 30, 2005	December 31, 2004
ASSETS:		
CURRENT ASSETS:		
Cash and cash equivalents	$ 72,458	$ 88,317
Restricted cash	20,502	26,175
Accounts and notes receivable-less allowances of $44,326 and $44,193, respectively	233,344	308,459
Energy commodity assets	397,649	284,231
Deposits with counterparties	43,079	30,667
Materials and supplies, fuel stock and natural gas stored	55,847	43,404
Deferred income taxes	10,841	12,288
Assets held for sale	12,970	28,479
Other current assets	81,943	80,680
Total current assets	928,633	902,700
NET UTILITY PROPERTY:		
Utility plant in service	2,766,626	2,666,445
Construction work in progress	67,920	51,260
Total	2,834,546	2,717,705
Less: Accumulated depreciation and amortization	792,464	761,642
Total net utility property	2,042,082	1,956,063
OTHER PROPERTY AND INVESTMENTS:		
Investment in exchange power-net	34,708	35,933
Non-utility properties and investments-net	77,238	78,564
Non-current energy commodity assets	406,943	254,657
Investment in affiliated trusts	13,403	13,403
Other property and investments-net	17,706	19,721
Total other property and investments	549,998	402,278
DEFERRED CHARGES:		
Regulatory assets for deferred income tax	123,944	123,159
Other regulatory assets	42,692	43,428
Non-current utility energy commodity derivative assets	99,806	55,825
Power and natural gas deferrals	134,871	148,206
Unamortized debt expense	50,443	53,413
Other deferred charges	23,385	21,109
Total deferred charges	475,141	445,140
TOTAL ASSETS	$ 3,995,854	$ 3,706,181

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED BALANCE SHEETS (continued)
(Unaudited)
Avista Corporation
Dollars in thousands

	June 30, 2005	December 31, 2004
LIABILITIES AND STOCKHOLDERS' EQUITY:		
CURRENT LIABILITIES:		
Accounts payable	$ 252,033	$ 325,194
Energy commodity liabilities	364,148	253,527
Deposits from counterparties	19,512	6,015
Current portion of long-term debt	77,550	85,432
Current portion of preferred stock-cumulative (17,500 shares outstanding)	1,750	1,750
Short-term borrowings	108,503	68,517
Interest accrued	17,988	18,632
Other current liabilities	116,958	117,331
Total current liabilities	958,442	876,398
LONG-TERM DEBT	874,711	901,556
LONG-TERM DEBT TO AFFILIATED TRUSTS	113,403	113,403
PREFERRED STOCK-CUMULATIVE (subject to mandatory redemption):		
10,000,000 shares authorized: $6.95 Series K 280,000 shares outstanding ($100 stated value)	28,000	28,000
OTHER NON-CURRENT LIABILITIES AND DEFERRED CREDITS:		
Non-current energy commodity liabilities	385,473	215,055
Regulatory liability for utility plant retirement costs	181,275	175,575
Non-current utility energy commodity derivative liabilities	42,173	33,490
Deferred income taxes	486,089	488,471
Other non-current liabilities and deferred credits	161,129	121,028
Total other non-current liabilities and deferred credits	1,256,139	1,033,619
TOTAL LIABILITIES	3,230,695	2,952,976
COMMITMENTS AND CONTINGENCIES (See Notes to Consolidated Financial Statements)		
STOCKHOLDERS' EQUITY:		
Common stock, no par value; 200,000,000 shares authorized; 48,532,080 and 48,471,511 shares outstanding	630,041	629,056
Note receivable from employee stock ownership plan	—	(495)
Capital stock expense and other paid in capital	(10,522)	(10,677)
Accumulated other comprehensive loss	(25,650)	(20,533)
Retained earnings	171,290	155,854
TOTAL STOCKHOLDERS' EQUITY	765,159	753,205
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 3,995,854	$ 3,706,181

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
Avista Corporation
For the Six Months Ended June 30
Dollars in thousands

	2005	2004
OPERATING ACTIVITIES:		
Net income	$ 28,793	$ 22,356
Cumulative effect of accounting change	—	460
Purchases of securities held for trading	—	(15,260)
Sales of securities held for trading	—	25,871
Non-cash items included in net income:		
Depreciation and amortization	44,094	38,313
Provision for deferred income taxes	950	(2,607)
Power and natural gas cost amortizations, net of deferrals	18,695	4,282
Amortization of debt expense	3,941	4,069
Gain on sale of natural gas distribution properties	(3,209)	—
Energy commodity assets and liabilities	17,304	3,444
Other	(10,835)	7,631
Changes in working capital components:		
Sale of customer accounts receivable under revolving agreement-net	(16,000)	(23,000)
Accounts and notes receivable	90,188	93,866
Materials and supplies, fuel stock and natural gas stored	(12,366)	(5,338)
Deposits with counterparties	(12,412)	(2,721)
Other current assets	12,059	7,261
Accounts payable	(72,020)	(45,934)
Deposits from counterparties	13,497	(12,994)
Other current liabilities	(13,967)	(2,577)
NET CASH PROVIDED BY OPERATING ACTIVITIES	88,712	97,122
INVESTING ACTIVITIES:		
Utility property capital expenditures (excluding AFUDC)	(115,300)	(46,528)
Other capital expenditures	(1,945)	(1,204)
Decrease (increase) in restricted cash	5,673	(25,874)
Proceeds from sale of natural gas distribution properties	15,633	—
Changes in other property and investments	(947)	1,979
Repayments received on notes receivable	60	1,009
NET CASH USED IN INVESTING ACTIVITIES	(96,826)	(70,618)
FINANCING ACTIVITIES:		
Increase in short-term borrowings	39,986	11,991
Redemption and maturity of long-term debt	(34,906)	(17,088)
Premiums paid for the redemption of long-term debt	(827)	(2,961)
Cash dividends paid	(13,092)	(12,333)
Issuance of common stock	1,294	2,151
Long- term debt and short-term borrowing issuance costs	(200)	(2,766)
NET CASH USED IN FINANCING ACTIVITIES	(7,745)	(21,006)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(15,859)	5,498
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	88,317	128,126
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 72,458	$133,624
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the period:		
Interest	$ 42,744	$ 41,732
Income taxes	9,579	9,677

The Accompanying Notes are an Integral Part of These Statements.

AVISTA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

The accompanying consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended June 30, 2005 and 2004 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results of operations for those 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, 2004 (2004 Form 10-K). Please refer to the section "Acronyms and Terms" in the 2004 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, northern Idaho, as well as northeast and southwest Oregon. In April 2005, the Company completed the sale of its South Lake Tahoe, California natural gas distribution properties (see Note 12 for further information). This was the Company's only regulated utility operations in California. 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. See Note 13 for business segment information.

The Company's operations are exposed to risks including, but not limited to, the 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, 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, the Company's facilities and operations may be exposed to terrorism risks or other malicious acts. In addition, the energy business exposes the Company to the financial, liquidity, credit and commodity price risks associated with wholesale purchases and sales.

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 unbilled revenues, the market value of energy commodity assets and liabilities, pension and other postretirement benefit plan obligations, contingent liabilities and recoverability of regulatory assets. 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.

Avista Utilities Operating Revenues

Operating revenues for Avista Utilities 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.

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Avista Energy Operating Revenues

Avista Energy follows Statement of Financial Accounting Standards (SFAS) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 138 and SFAS No. 149, with respect to the majority of its contracts. 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, as well as derivative commodity instruments not held for trading, are reported on a gross basis in operating revenues. Revenues from Canadian contracts through Avista Energy Canada, which are not held for trading, and are reported on gross basis in operating revenues, totaled $28.8 million and $25.8 million for the three months ended June 30, 2005 and 2004, respectively. Revenues from Canadian contracts through Avista Energy Canada totaled $66.2 million and $60.4 million for the six months ended June 30, 2005 and 2004, respectively.

Other Income-Net

Other income-net consisted of the following items for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Interest income	$ 939	$ 499	$ 2,006	$ 2,202
Interest on power and natural gas deferrals	1,792	1,930	3,780	3,945
Net gain on disposition of non-operating assets	—	362	14	371
Net gain (loss) on investments	(162)	494	(341)	(213)
Other expense	(1,300)	(1,040)	(2,929)	(2,985)
Other income	571	471	1,132	1,052
Total	$ 1,840	$ 2,716	$ 3,662	$ 4,372

Stock-Based Compensation

The Company follows the disclosure only provisions of SFAS No. 123, “Accounting for Stock-Based Compensation.” Accordingly, employee stock options are accounted for under Accounting Principle Board Opinion (APB) No. 25, “Accounting for Stock Issued to Employees.” Stock options are granted at exercise prices not less than the fair value of common stock on the date of grant. Under APB No. 25, no compensation expense is recognized pursuant to the Company’s stock option plans. See Note 2 with respect to the revision of SFAS No. 123, which will result in the recognition of compensation expense beginning in 2006.

If compensation expense for the Company’s stock option plans were determined consistent with SFAS No. 123, net income and earnings per common share would have been the following pro forma amounts for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income (dollars in thousands):				
As reported	$18,604	$10,132	$28,793	$22,356
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards, net of tax	251	555	501	1,110
Pro forma	$18,353	$ 9,577	$28,292	$21,246
Basic and diluted earnings per common share:				
Basic and diluted, as reported	$ 0.38	$ 0.21	$ 0.59	$ 0.46
Basic pro forma	$ 0.38	$ 0.20	$ 0.58	$ 0.44
Diluted pro forma	$ 0.38	$ 0.20	$ 0.58	$ 0.43

Comprehensive Income (Loss)

The Company’s comprehensive income (loss), which is reported net of tax, is comprised of net income, foreign currency translation adjustments, changes in the unfunded accumulated benefit obligation for the pension plan, unrealized gains and losses on interest rate swap agreements, and unrealized gains and losses on derivative commodity instruments.

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Accumulated other comprehensive income (loss), net of tax, consisted of the following as of June 30, 2005 and December 31, 2004 (dollars in thousands):

	June 30, 2005	December 31, 2004
Foreign currency translation adjustment	$ 1,026	$ 1,139
Unfunded accumulated benefit obligation for the pension plan	(16,944)	(16,944)
Unrealized loss on interest rate swap agreements	(10,947)	(4,820)
Unrealized loss on securities available for sale	(157)	—
Unrealized gain on derivative commodity instruments	1,372	92
Total accumulated other comprehensive loss	$(25,650)	$ (20,533)

Restricted Cash

Restricted cash includes bank deposits of $8.2 million and $21.5 million as collateral for letters of credit issued under Avista Energy's credit agreement as of June 30, 2005 and December 31, 2004, respectively. See Note 8 for further information with respect to Avista Energy's credit agreement. Restricted cash also includes deposits held in trust of $1.1 million and $1.6 million for certain employees of Avista Energy as part of a bonus retention plan as of June 30, 2005 and December 31, 2004, respectively. Restricted cash as of June 30, 2005 and December 31, 2004, includes $2.5 million of deposits related to forward contracts at Avista Energy. In addition, restricted cash includes $8.7 million and $0.6 million of deposits related to Avista Corp.'s interest rate swap agreements as of June 30, 2005 and December 31, 2004, respectively. See Note 9 for further information with respect to Avista Corp.'s interest rate swap agreements.

Assets Held for Sale

Assets held for sale are recorded at the lower of cost or estimated fair value less selling costs. As of June 30, 2005 assets held for sale included $13.0 million of turbines and related equipment. As of December 31, 2004 assets held for sale included $15.2 million of assets related to Avista Utilities' South Lake Tahoe natural gas distribution properties and $13.3 million of turbines and related equipment. Liabilities held for sale were not significant as of June 30, 2005 and December 31, 2004.

Goodwill

Goodwill arising from acquisitions represents the excess of the purchase price over the estimated fair value of net assets acquired. The Company evaluates goodwill for impairment using a discounted cash flow model on at least an annual basis or more frequently if impairment indicators arise. Goodwill is included in non-utility properties and investments-net on the Consolidated Balance Sheets and totaled $6.2 million ($5.2 million in the Other business segment and $1.0 million in Energy Marketing and Resource Management) as of June 30, 2005 and December 31, 2004. During the three months ended June 30, 2005, the Company changed the date of its annual goodwill impairment test to November 30 from March 31. The Company selected the date of November 30 as it is closely aligned with the Company's annual budget and forecasting process. In addition, the new date provides the Company additional time to meet accelerated public reporting requirements. The Company believes the change will not delay, accelerate or avoid an impairment charge. Accordingly, the Company believes that the accounting change described above is to an alternative accounting principle that is preferable under the circumstances.

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 (i) the Company's rates for regulated services are established by or subject to approval by an independent third-party regulator; (ii) the regulated rates are designed to recover the Company's cost of providing the regulated services; and (iii) 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 the Company's 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 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 with respect to all or a portion of the Company's regulated operations, the Company could be required to write off its regulatory assets. The Company could also be 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.

AVISTA CORPORATION

The Company's primary regulatory assets include power and natural gas deferrals (see "Power Cost Deferrals and Recovery Mechanisms" and "Natural Gas Cost Deferrals and Recovery Mechanisms" below for further information), investment in exchange power, regulatory asset for deferred income taxes, unamortized debt expense, regulatory asset for consolidation of variable interest entity, demand side management programs, conservation programs and the provision for postretirement benefits. Those items without a specific line on the Consolidated Balance Sheets are included in other regulatory assets.

Other regulatory assets consisted of the following as of June 30, 2005 and December 31, 2004 (dollars in thousands):

	June 30, 2005	December 31, 2004
Regulatory asset for consolidation of variable interest entity	$20,396	$ 19,167
Regulatory asset for postretirement benefit obligation	3,546	3,782
Demand side management and conservation programs	11,584	13,792
Other	7,166	6,687
Total	$42,692	$ 43,428

Regulatory liabilities include utility plant retirement costs. Deferred credits include, among other items, regulatory liabilities created when the Centralia Power Plant was sold, regulatory liabilities offsetting net energy commodity derivative assets (see Note 4 for further information) and the gain on the general office building sale/leaseback, which is being amortized over the life of the lease, and are included on the Consolidated Balance Sheets as other current liabilities and other non-current liabilities and deferred credits.

Natural Gas Benchmark Mechanism

The Idaho Public Utilities Commission (IPUC), Washington Utilities and Transportation Commission (WUTC) and Oregon Public Utility Commission (OPUC) approved Avista Utilities' Natural Gas Benchmark Mechanism in 1999. The mechanism eliminated the majority of natural gas procurement operations within Avista Utilities and placed responsibility for natural gas procurement operations with Avista Energy, the Company's non-regulated subsidiary. The ownership of the natural gas assets remained with Avista Utilities; however, the assets were managed by Avista Energy through an Agency Agreement. Avista Utilities always managed natural gas procurement for its California operations, which the Company sold in April 2005 (see Note 12).

Effective April 1, 2005, the Natural Gas Benchmark Mechanism and related Agency Agreement were terminated and the management of natural gas procurement functions was moved from Avista Energy back to Avista Utilities. This was required for Washington customers by WUTC orders issued over one year earlier, in February 2004, and Avista Utilities' resulting transition plan approved by the WUTC in April 2004. The Company also elected to move these functions back to Avista Utilities for Idaho and Oregon natural gas customers.

In accordance with SFAS No. 71, profits recognized by Avista Energy on natural gas sales to Avista Utilities, including gains and losses on natural gas contracts, are not eliminated in the consolidated financial statements. This is due to the fact that Avista Utilities expects to recover the costs of natural gas purchases to serve retail customers and for fuel for electric generation through future retail rates.

Power Cost Deferrals and Recovery Mechanisms

Avista Utilities defers the recognition in the income statement of certain power supply costs as approved by the WUTC. Deferred power supply costs are recorded as a deferred charge on the Consolidated Balance Sheets for future review and the opportunity for recovery through retail rates. The power supply costs deferred include certain differences between actual power supply costs incurred by Avista Utilities and the costs included in base retail rates. This difference in power supply costs primarily results from changes in short-term wholesale market prices, changes in the level of hydroelectric generation and changes in the level of thermal generation (including changes in fuel prices). Avista Utilities accrues interest on deferred power costs in the Washington jurisdiction at a rate, which is adjusted semi-annually, of 8.3 percent as of June 30, 2005. Total deferred power costs for Washington customers were $102.6 million and $113.2 million as of June 30, 2005 and December 31, 2004, respectively.

In Washington, the Energy Recovery Mechanism (ERM) allows Avista Utilities to increase or decrease electric rates periodically with WUTC approval to reflect changes in power supply costs. The ERM provides for Avista Utilities to incur the cost of, or receive the benefit from, the first $9.0 million in annual power supply costs above or below the amount included in base retail rates. Under the ERM, 90 percent of annual power supply costs exceeding or

below the initial $9.0 million are deferred for future surcharge or rebate to Avista Utilities' customers. The remaining 10 percent of power supply costs are an expense of, or benefit to, the Company.

Under the ERM, Avista Utilities makes an annual filing 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. Avista Utilities made its annual filing with the WUTC on March 30, 2005 related to $10.8 million of deferred power costs incurred for 2004. On June 29, 2005, the WUTC issued an order, which approved the recovery of the $10.8 million of deferred power costs incurred for 2004.

Avista Utilities has a power cost adjustment (PCA) mechanism in Idaho that allows it to modify electric rates periodically with IPUC approval. Under the PCA mechanism, Avista Utilities defers 90 percent of the difference between certain actual net power supply expenses and the authorized level of net power supply expense approved in the last Idaho general rate case. Avista Utilities accrues interest on deferred power costs in the Idaho jurisdiction at a rate, which is adjusted annually, of 2.0 percent on current year deferrals and 4.0 percent on carryover balances as of June 30, 2005. Total deferred power costs for Idaho customers were $5.9 million and $9.5 million as of June 30, 2005 and December 31, 2004, respectively.

Natural Gas Cost Deferrals and Recovery Mechanisms

Under established regulatory practices in each respective state, Avista Utilities is allowed to adjust its natural gas rates periodically (with regulatory approval) to reflect increases or decreases in the cost of natural gas purchased. Differences between actual natural gas costs and the natural gas costs already included in retail rates are deferred and charged or credited to expense when regulators approve inclusion of the cost changes in rates. Total deferred natural gas costs were $26.4 million and $28.6 million as of June 30, 2005 and December 31, 2004, respectively.

Reclassifications

Certain prior period amounts were reclassified to conform to current statement format. These reclassifications were made for comparative purposes and to conform to changes in accounting standards and have not affected previously reported total net income or stockholders' equity. In particular, the net change in restricted cash for the six months ended June 30, 2004 has been reclassified from operating activities to investing activities in the Consolidated Statements of Cash Flows to conform to the Company's 2005 presentation. This has resulted in a $25.9 million increase to operating cash flows and a corresponding decrease to investing cash flows from the amounts previously reported for the six months ended June 30, 2004.

NOTE 2. NEW ACCOUNTING STANDARDS

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, "Consolidation of Variable Interest Entities," which was revised in December 2003 (collectively referred to as FIN 46). In general, a variable interest entity does not have equity investors with voting rights or it has equity investors that do not provide sufficient financial resources for the entity to support its activities. Variable interest entities are commonly referred to as special purpose entities or off-balance sheet structures; however, FIN 46 applies to a broader group of entities. FIN 46 requires a variable interest entity to be consolidated by the primary beneficiary of that entity. The primary beneficiary is subject to a majority of the risk of loss from the variable interest entity's activities or it is entitled to receive a majority of the entity's residual returns. FIN 46 also requires disclosure of variable interest entities that a company is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 applied immediately to variable interest entities created after January 31, 2003 and applied to certain existing variable interest entities for the first fiscal year or interim period ending after December 15, 2003. Application for all other types of entities was required for periods ending after March 15, 2004.

Please refer to the 2004 Form 10-K for the effects of the application of FIN 46 prior to the first quarter of 2004, which resulted in the consolidation of WP Funding LP and the deconsolidation of capital trusts. The implementation of FIN 46, as revised in December 2003, resulted in the Company including a partnership as well as several low-income housing project investments held in the Other business segment in its consolidated financial statements beginning in the first quarter of 2004. This resulted in a charge of $0.5 million recorded as a cumulative effect of accounting change for the six months ended June 30, 2004.

In December 2004, the FASB issued SFAS No. 123R, "Accounting for Stock-Based Compensation," which supersedes APB No. 25 and its related implementation guidance. This statement establishes revised standards for the accounting for transactions in which the Company exchanges its equity instruments for goods or services with a

primary focus on transactions in which the Company obtains employee services in share-based payment transactions. The statement requires that the compensation cost relating to share-based payment transactions be recognized in financial statements based on the fair value of the equity or liability instruments issued. In April 2005, the Securities and Exchange Commission issued a rule, which delays the Company's implementation of the provisions of this statement from the third quarter of 2005 to the first quarter of 2006. The Company expects to record compensation expense (net of tax) of approximately $0.4 million in 2006 related to the periodic vesting of stock options granted to employees prior to 2005. The Company is evaluating the effect this statement may have on the valuation and expense of certain forms of stock-based compensation (including performance shares) that have been and may be granted to employees.

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143." This interpretation clarifies that the term "conditional asset retirement obligation" refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. The Company will be required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This interpretation also clarifies when the Company would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company will be required to adopt this interpretation by the end of 2005. The Company is evaluating the impact this statement will have on its financial condition and results of operations.

NOTE 3. 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 22, 2005, 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 May 29, 2005 to March 21, 2006. 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 operating expenses of Avista Corp. As of June 30, 2005 and December 31, 2004, $56.0 million and $72.0 million in accounts receivables were sold, respectively, under this revolving agreement.

NOTE 4. UTILITY ENERGY COMMODITY DERIVATIVE ASSETS AND LIABILITIES

SFAS No. 133, as amended by SFAS No. 138 and SFAS No. 149, 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 energy. 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 5. In conjunction with the issuance of SFAS No. 133, the WUTC and the 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 or 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 ERM and the PCA mechanism.

Prior to the adoption of SFAS No. 149 on July 1, 2003, Avista Utilities elected the normal purchases and sales exception for substantially all of its contracts for both capacity and energy under SFAS No. 133. As such, Avista Utilities was not required to record these contracts as derivative commodity assets and liabilities. Under SFAS No. 149, substantially all new forward contracts to purchase or sell power and natural gas used for generation, which

were entered into on or after July 1, 2003, are recorded as assets or liabilities at market 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 June 30, 2005 and December 31, 2004 (dollars in thousands):

	June 30, 2005	December 31, 2004
Current utility energy commodity derivative asset	$25,883	$ 12,557
Current utility energy commodity derivative liability	1,304	8,071
Net current regulatory liability	24,579	4,486
Non-current utility energy commodity derivative asset	99,806	55,825
Non-current utility energy commodity derivative liability	42,173	33,490
Net non-current regulatory liability	57,633	22,335

Current utility energy commodity derivative assets are included in other current assets on the Consolidated Balance Sheets. Current utility energy commodity derivative liabilities and the offsetting net current regulatory liability are included in other current liabilities on the Consolidated Balance Sheets. The offsetting net non-current regulatory liability is included in other non-current liabilities and deferred credits on the Consolidated Balance Sheets.

NOTE 5. 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. In order to manage the various risks relating to these exposures, Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options, 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 pursuit of economic resources to serve load obligations and using existing resources to capture available economic value. Avista Utilities sells and purchases wholesale electric capacity and energy to and from utilities and other entities as part of the process of acquiring resources to serve its retail and wholesale load obligations. These transactions range from a term as short as one hour up to long-term contracts that extend beyond one year. Avista Utilities makes continuing projections of (1) future retail and wholesale loads based on, among other things, forward estimates of factors such as customer usage and weather as well as historical data and contract terms and (2) resource availability based on, among other things, estimates of streamflows, generating unit availability, historic and forward market information and experience. On the basis of these continuing projections, Avista Utilities makes purchases and sales of energy on an annual, quarterly, monthly, daily and hourly basis to match expected resources to expected energy requirements. Resource optimization also includes transactions such as purchasing fuel to run thermal generation and, when economic, selling fuel and substituting electric wholesale market purchases for the operation of Avista Utilities’ own resources, as well as other wholesale transactions to capture the value of available generation and transmission resources. This optimization process includes entering into financial and physical hedging transactions as a means of managing risks.

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 was responsible for the daily management of natural gas supplies to meet the requirements of Avista Utilities’ customers in the states of Washington, Idaho and Oregon. Effective April 1, 2005, the management of natural gas procurement functions was moved from Avista Energy back to Avista Utilities. This

was required for Washington customers by WUTC orders issued over one year earlier, in February 2004, and Avista Utilities' resulting transition plan approved by the WUTC in April 2004. The Company also elected to move these functions back to Avista Utilities for Idaho and Oregon natural gas customers. As part of the transition plan, Avista Utilities began procuring natural gas for load service during the second half of 2004 and the first quarter of 2005. This procurement process includes entering into financial and physical hedging transactions as a means of managing risks. Avista Utilities always managed natural gas procurement for its California operations, which the Company sold in April 2005 (see Note 12).

Avista Energy

Avista Energy is an electricity and natural gas marketing, trading and resource management business. Avista Energy focuses on 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 is also involved in trading electricity and natural gas, including derivative commodity instruments. Avista Energy purchases natural gas and electricity from producers and energy marketing and trading companies. Its customers include commercial and industrial end-users, electric utilities, natural gas distribution companies, and energy marketing and trading companies.

Avista Energy's marketing and energy risk management services are provided through the use of a variety of derivative commodity contracts to purchase or supply natural gas and electric energy at specified delivery points and at specified future dates. Avista Energy trades natural gas and electricity derivative commodity instruments on national exchanges and through other exchanges and brokers, and therefore can experience net open positions in terms of price, volume, and specified delivery point. The open positions expose Avista Energy to the risk that fluctuating market prices may adversely impact its financial condition or results of operations. However, the net open positions are actively managed with policies designed to limit the exposure to market risk and requiring daily reporting to management of potential financial exposure.

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. VAR measures the expected portfolio loss under hypothetical adverse price movements over a given time interval within a given confidence level. Avista Energy also measures its open positions in terms of volumes at each delivery location for each forward time period. The permissible extent of open positions is included in the risk management policy and is measured with stress tests and VAR modeling.

Derivative commodity instruments sold and purchased by Avista Energy include: forward contracts, which involve physical delivery of an energy commodity; futures contracts, which involve the buying or selling of natural gas or electricity at a fixed price; over-the-counter swap agreements, which require Avista Energy to receive or make payments based on the difference between a specified price and the actual price of the underlying commodity; and options, which mitigate price risk by providing for the right, but not the requirement, to buy or sell energy-related commodities at a fixed price. Foreign currency risks are primarily related to Canadian exchange rates and are managed using standard instruments available in the foreign currency markets.

Avista Energy's derivative commodity instruments accounted for under SFAS No. 133 are subject to mark-to-market accounting, under which changes in the market value of outstanding electric, natural gas and related derivative commodity instruments are recognized as unrealized gains or losses in the Consolidated Statements of Income in the period of change. Market prices are utilized in determining the value of electric, natural gas and related derivative commodity instruments, which are reported as assets and liabilities on the Consolidated Balance Sheets. These market prices are used through 36 months. For longer-term positions and certain short-term positions for which market prices are not available, a model to estimate forward price curves is utilized. 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, as well as derivative commodity instruments not held for trading, are reported on a gross basis in operating revenues. Costs from contracts, which are not derivatives under SFAS No. 133 and derivative instruments not held for trading, are reported on a gross basis in resource costs. Contracts in a receivable position, as well as the options held, are reported as assets. Similarly, contracts in a payable position, as well as options written, are reported as liabilities. Net cash flows are recognized in the period of settlement.

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), as well as the 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 and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Gain related to hedge ineffectiveness recorded in operating revenues	$ 436	$ 350	$ 726	$ 937
Gain (loss) reclassified from accumulated other comprehensive income (loss) and recognized in earnings (pre-tax)	62	15	649	(76)

The following table presents the net gain (loss), net of tax, related to Avista Energy's cash flow hedges as of June 30, 2005 and December 31, 2004 (dollars in thousands):

	June 30, 2005	December 31, 2004
Accumulated other comprehensive income related to natural gas derivatives	$ 5,857	$ 1,556
Accumulated other comprehensive loss related to electric derivatives	(4,485)	(1,464)
Total accumulated other comprehensive income	$ 1,372	$ 92

Avista Energy expects to recognize a gain of $0.9 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 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 was 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 June 30, 2005 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	32,137	35,692	12	3,299	3,029	3
Natural gas	304,950	291,654	4	1,608,380	1,608,483	3

The weighted average term of Avista Energy's electric derivative commodity instruments as of June 30, 2005 was approximately 8 months. The weighted average term of Avista Energy's natural gas derivative commodity instruments as of June 30, 2005 was approximately 4 months.

Estimated Fair Value The estimated fair value of Avista Energy's derivative commodity instruments outstanding as of June 30, 2005, and the average estimated fair value of those instruments held during the six months ended June 30, 2005, are set forth below (dollars in thousands):

	Estimated Fair Value as of June 30, 2005				Average Estimated Fair Value for the six months ended June 30, 2005			
	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities	Current Assets	Long-term Assets	Current Liabilities	Long-term Liabilities
Electric	$ 239,090	$ 382,170	$ 208,632	$ 367,777	$ 228,139	$ 294,088	$ 206,537	$ 266,551
Natural gas	158,559	24,773	155,516	17,696	113,728	19,197	107,764	16,384
Total	$ 397,649	$ 406,943	$ 364,148	$ 385,473	$ 341,867	$ 313,285	$ 314,301	$ 282,935

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 six months ended June 30, 2005 was an unrealized loss of $17.3 million and is included in the Consolidated Statements of Income in operating revenues. The change in the fair value position for the six months ended June 30, 2004 was an unrealized loss of $3.4 million.

NOTE 6. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS

The Company has a defined benefit pension plan covering substantially all of its 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 2004. The Company expects to contribute approximately $15 million to the pension plan in 2005 ($7.5 million was contributed during the six months ended June 30, 2005).

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 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 and six months ended June 30 (dollars in thousands):

	Pension Benefits		Postretirement Benefits	
	2005	2004	2005	2004
Three months ended June 30:				
Service cost	$ 2,325	$ 2,025	$ 129	$ 125
Interest cost	4,046	4,162	503	620
Expected return on plan assets	(4,000)	(3,425)	(319)	(300)
Transition (asset)/obligation recognition	(272)	(275)	126	250
Amortization of prior service cost	164	100	—	—
Net loss recognition	1,202	1,138	186	205
Net periodic benefit cost	$ 3,465	$ 3,725	$ 625	$ 900
Six months ended June 30:				
Service cost	$ 4,650	$ 4,050	$ 264	$ 250
Interest cost	8,092	8,324	1,025	1,240
Expected return on plan assets	(8,000)	(6,850)	(638)	(600)
Transition (asset)/obligation recognition	(544)	(550)	252	500
Amortization of prior service cost	328	200	—	—
Net loss recognition	2,165	2,276	297	410
Net periodic benefit cost	$ 6,691	$ 7,450	$1,200	$1,800

AVISTA CORPORATION

NOTE 7. LONG-TERM DEBT

The following details the interest rate and maturity dates of long-term debt outstanding as of June 30, 2005 and December 31, 2004 (dollars in thousands):

Maturity Year	Description	Interest Rate	June 30, 2005	December 31, 2004
2005	Secured Medium-Term Notes	6.39%-6.68%	$ 21,500	$ 29,500
2005	WP Funding LP Note	8.38%	54,572	54,572
2006	Secured Medium-Term Notes	7.89%-7.90%	30,000	30,000
2007	First Mortgage Bonds	7.75%	150,000	150,000
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	7.26%-7.45%	22,500	27,500
2019	First Mortgage Bonds	5.45%	90,000	90,000
2023	Secured Medium-Term Notes	7.18%-7.54%	13,500	24,500
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
	Total secured long-term debt		636,622	660,622
2006	Unsecured Medium-Term Notes	8.14%	8,000	8,000
2007	Unsecured Medium-Term Notes	5.99%-7.94%	12,000	12,000
2008	Unsecured Senior Notes	9.75%	280,686	280,827
2022	Unsecured Medium-Term Notes	8.15%	—	5,000
2023	Unsecured Medium-Term Notes	7.99%	—	5,000
2023	Pollution Control Bonds	6.00%	4,100	4,100
	Total unsecured long-term debt		304,786	314,927
	Other long-term debt and capital leases		12,281	13,047
	Unamortized debt discount		(1,428)	(1,608)
	Total		952,261	986,988
	Current portion of long-term debt		(77,550)	(85,432)
	Total long-term debt		$ 874,711	$ 901,556

In January and February 2005, the Company redeemed the following debt securities: $5.0 million of Secured Medium-Term Notes scheduled to mature in 2018; $11.0 million of Secured Medium-Term Notes scheduled to mature in 2023; $5.0 million Unsecured Medium-Term Notes scheduled to mature in 2022; and $5.0 million of Unsecured Medium-Term Notes scheduled to mature in 2023. In accordance with regulatory accounting practices, the total net premium on the redemption of debt of $0.8 million will be amortized over the average remaining maturity of outstanding debt.

NOTE 8. SHORT-TERM BORROWINGS

On December 17, 2004, the Company entered into a five-year committed line of credit with various banks in the amount of $350.0 million with an expiration date of December 16, 2009. This committed line of credit replaced a $350.0 million committed line of credit with a 364-day term that had an expiration date of May 5, 2005. As of June 30, 2005 and December 31, 2004, the Company had $108.0 million and $68.0 million, respectively, of borrowings outstanding under this committed line of credit. The Company can request the issuance of up to $150.0 million in letters of credit under the committed line of credit. As of June 30, 2005 and December 31, 2004, there were $20.0 million and $32.8 million in letters of credit outstanding, respectively. The committed line of credit is secured by $350.0 million of non-transferable First Mortgage Bonds of the Company 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 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 covenants not to 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. As of June 30, 2005, the Company was in compliance with this

covenant with a ratio of 59.6 percent. The committed line of credit also has a covenant requiring the ratio of “earnings before interest, taxes, depreciation and amortization” to “interest expense” of Avista Utilities for the twelve-month period ending June 30, 2005 to be greater than 1.6 to 1. As of June 30, 2005, the Company was in compliance with this covenant with a ratio of 2.56 to 1.

On July 13, 2005, Avista Energy and its subsidiary, Avista Energy Canada, as co-borrowers, amended its committed credit agreement with a group of banks to increase the aggregate amount from $110.0 million to $145.0 million and to extend the expiration date to July 12, 2007. 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 amendment to the credit agreement increased the maximum amount for cash advances from $30.0 million to $50.0 million. No cash advances were outstanding as of June 30, 2005 and December 31, 2004. Letters of credit in the aggregate amount of $85.4 million and $91.3 million were outstanding as of June 30, 2005 and December 31, 2004, respectively. The cash deposits of Avista Energy at the respective banks collateralized $8.2 million and $21.5 million of these letters of credit as of June 30, 2005 and December 31, 2004, respectively, which is reflected as restricted cash on the Consolidated Balance Sheets.

The Avista Energy credit agreement continues to contain 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 continues to contain 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 current 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 June 30, 2005. Prior to the July 13, 2005 amendment, a reduction in the credit rating of Avista Corp. would have represented an event of default under Avista Energy’s credit agreement. The July 13, 2005 amendment to the credit agreement removed this covenant.

NOTE 9. INTEREST RATE SWAP AGREEMENTS

In 2004, Avista Corp. entered into three forward-starting interest rate swap agreements, totaling $200.0 million, to manage the risk that changes in interest rates may affect the amount of future interest payments. These interest rate swap agreements relate to the anticipated issuances of debt to fund debt that matures in 2007 and 2008. Under the terms of these agreements, the value of the interest rate swaps are determined based upon Avista Corp. paying a fixed rate and receiving a variable rate based on LIBOR for a term of seven years beginning in 2007 and a term of ten years beginning in 2008. The interest rate swap agreements entered in 2004 provide for mandatory cash settlement of these contracts in 2008 and 2009. In June 2005, Avista Corp. entered into a forward-starting interest rate swap agreement in the amount of $50.0 million related to the anticipated issuance of debt to fund debt that matures during the second half of 2005. The value of the interest rate swap is determined based upon Avista Corp. paying a fixed rate and receiving a variable rate based on LIBOR for a term of thirty years beginning in December 2005. The interest rate swap agreement provides for mandatory cash settlement of the contract in 2006.

These interest rate swap agreements are considered hedges against fluctuations in future cash flows associated with changes in interest rates in accordance with SFAS No. 133. As of June 30, 2005, Avista Corp. had a derivative liability of $16.4 million. An unrealized loss of $6.5 million (net of taxes of $3.5 million) was recorded in other comprehensive loss for the six months ended June 30, 2005. As of June 30, 2005, there was an unrealized loss of $10.7 million recorded as accumulated other comprehensive loss on the Consolidated Balance Sheets. The Company may request regulatory accounting orders to defer the impact of unrealized gains and losses. If such accounting orders were obtained, the Company would record a regulatory asset or liability, which would eliminate the effect of any unrealized gains and losses on these interest rate swap agreements in the Consolidated Statements of Comprehensive Income. If regulatory accounting orders are not obtained prior to the mandatory cash settlements in 2008 and 2009, the amount included in accumulated other comprehensive income or loss at the cash settlement date will be reclassified to unamortized debt expense in accordance with regulatory accounting practices under SFAS No. 71. This gain or loss will be amortized over the remaining life of the forecasted debt issued.

Rathdrum Power, LLC (RP LLC), an unconsolidated entity that is 49 percent owned by Avista Power, operates a 270 MW natural gas-fired combustion turbine plant in northern Idaho (Lancaster Project). Avista Power's investment in RP LLC, which is included in non-utility properties and investments-net on the Consolidated Balance Sheets, is accounted for under the equity method and totaled $18.3 million as of June 30, 2005. As of June 30, 2005, RP LLC had $114.1 million of debt outstanding that is not included in the consolidated financial statements of the Company. There is no recourse to the Company with respect to this debt. RP LLC has entered into two interest rate swap agreements, maturing in 2006, to manage the risk that changes in interest rates may affect the amount of future interest payments. RP LLC agreed to pay fixed rates of interest with the differential paid or received under the interest rate swap agreements recognized as an adjustment to interest expense. These interest rate swap agreements are considered hedges against fluctuations in future cash flows associated with changes in interest rates in accordance with SFAS No. 133. The fair value of the interest rate swap agreements was determined by reference to market values obtained from various third party sources. As of June 30, 2005, there was an unrealized loss of $0.3 million recorded as accumulated other comprehensive loss on the Consolidated Balance Sheets.

NOTE 10. EARNINGS PER COMMON SHARE

The following table presents the computation of basic and diluted earnings per common share for the three and six months ended June 30 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Numerator:				
Net income before cumulative effect of accounting change	$18,604	$10,132	$28,793	$22,816
Cumulative effect of accounting change	—	—	—	(460)
Net income	$18,604	$10,132	$28,793	$22,356
Denominator:				
Weighted-average number of common shares outstanding-basic	48,508	48,384	48,493	48,368
Effect of dilutive securities:				
Contingent stock	154	234	154	234
Stock options	242	263	246	281
Weighted-average number of common shares outstanding-diluted	48,904	48,881	48,893	48,883
Earnings per common share, basic and diluted:				
Earnings per common share before cumulative effect of accounting change	$ 0.38	$ 0.21	$ 0.59	$ 0.47
Loss per common share from cumulative effect of accounting change	—	—	—	(0.01)
Total earnings per common share, basic and diluted	$ 0.38	$ 0.21	$ 0.59	$ 0.46

Total stock options outstanding that were not included in the calculation of diluted earnings per common share were 699,000 for the three and six months ended June 30, 2005. Total stock options outstanding that were not included in the calculation of diluted earnings per common share were 762,200 for the three and six months ended June 30, 2004. 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 11. 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. In addition to issues specifically identified in this Note and with respect to matters that affect the regulated utility operations, the Company intends to seek, to the extent appropriate, regulatory approval of recovery of incurred costs through the ratemaking process.

AVISTA CORPORATION

Federal Energy Regulatory Commission Inquiry

On April 19, 2004, the Federal Energy Regulatory Commission (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. As part of the Agreement in Resolution, Avista Utilities agreed to continue to record conversations of energy traders for two years and to improve its account settlement process. Avista Utilities and Avista Energy agreed to maintain an annual training program on the applicable FERC Code of Conduct for all employees engaged in the trading of electric energy and capacity. The Agreement in Resolution imposes no monetary remedies or penalties against Avista Utilities or Avista Energy. On May 19, 2004, the City of Tacoma and California Parties (the Office of the Attorney General, the California Public Utilities Commission (CPUC), and the California Electricity Oversight Board, filing jointly) filed requests for rehearing with respect to the FERC's April 19, 2004 order. On September 28, 2004, the State of Montana filed a motion to intervene in these proceedings. On April 19, 2005, the FERC denied the rehearing requests of the City of Tacoma and California Parties, and denied the State of Montana's motion to intervene. On April 28, 2005 and June 14, 2005, the California Parties and the City of Tacoma, respectively, filed appeals with the United States Court of Appeals for the Ninth Circuit in response to the FERC's denial of rehearing requests. Based on the FERC's order approving the Agreement in Resolution and the FERC's denial of rehearing requests and motion to intervene, 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 September 27, 2002, Ronald R. Wambolt filed a class action lawsuit 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 the Company, Gary G. Ely, the current Chairman of the Board, President and Chief Executive Officer of the Company, and Jon E. Eliassen, the former Senior Vice President and Chief Financial Officer of the Company. In October and November 2002, Gail West, Michael Atlas and Peter Arnone filed similar class action lawsuits in the same court against the same parties. On February 3, 2003, the court issued an order consolidating the complaints under the name "In re Avista Corp. Securities Litigation," and on February 7, 2003 appointed the lead plaintiff and co-lead counsel. On August 19, 2003, the plaintiffs filed their consolidated amended class action complaint in the same court against the same parties. In their complaint, the plaintiffs continue to assert violations of the federal securities laws in connection with alleged misstatements and omissions of material fact pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The plaintiffs allege that the Company did not have adequate risk management processes, procedures and controls. The plaintiffs further allege that the Company engaged in unlawful energy trading practices and allegedly manipulated 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. The Company filed a motion to dismiss this complaint in October 2003 and the plaintiffs filed an answer to this motion in January 2004. Arguments before the Court on the motion were held on March 19, 2004. On April 15, 2004, the Court called for additional briefing on what effect, if any, the FERC proceedings (see "Federal Energy Regulatory Commission Inquiry" above) have on this case. On July 30, 2004, the Court denied the Company's motion to dismiss this complaint, holding, among other things, that the FERC proceedings may ultimately have some evidentiary value relevant to the disclosure issues raised in this case, but they do not preclude the resolution of those issues by the Court. In November 2004, the Company filed its answer to the complaint denying the plaintiffs' allegations. 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. In July 2005, the plaintiffs responded to the Company's motion for reconsideration and the matter is scheduled for arguments in September 2005 before the United States District Court for the Eastern District of Washington. 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. 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.

Counterparty Defaults

In 2001, Pacific Gas & Electric (PG&E) and Southern California Edison (SCE) defaulted on payment obligations to the California Power Exchange (CalPX) and the California Independent System Operator (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; however the funds SCE paid to the CalPX have yet to be released to energy sellers. 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 (see discussion below). As of June 30, 2005, 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. Avista Energy continues to defend itself in the California Refund Proceeding and pursue recovery of the defaulted obligations. Because the resolution of these defaulted obligations by counterparties remains uncertain, legal counsel cannot express an opinion on the extent, if any, of the Company's liability for potential refunds beyond the defaulted obligations. However, based on information currently known to the Company's management, the Company does not expect that the resolution of these defaulted obligations will have a material adverse effect 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.

California Refund Proceeding

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 CalISO and the CalPX during the period from October 2, 2000 to June 20, 2001 in the California power market. The refunds were 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 in the future to document these costs and limit its refund liability commensurately. The FERC administrative law judge's findings were certified in December 2002. In March 2003, the FERC reviewed the administrative law judge's rulings, adopting many of his findings. The CalISO continues its efforts to prepare revised settlement statements based on newly recalculated costs and charges for spot market sales to California during the refund period and currently estimates that it will make its compliance filing showing "who owes what to whom" in 2006. In January 2005, Avista Energy made filings responding to the FERC's invitation to comment on the proper approach governing revenue shortfall studies that the FERC has determined may be filed by sellers in these proceedings. Avista Energy is currently awaiting the FERC's action on that issue.

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. Market participants with bids above $250 per MW during the period described above have been required to demonstrate why their bidding behavior and practices did not violate applicable market rules. If violations were found to exist, the FERC would require the refund of any unjust profits and could also enforce other non-monetary penalties, such as the revocation of market-based rate authority. Avista Energy was subject to this review. 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, appealed the FERC's decision before 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. Oral argument on those issues took place in April 2005. 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. 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.

AVISTA CORPORATION

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 to June 20, 2001 were just and reasonable. During the hearing, Avista Utilities and Avista Energy vigorously opposed claims that Pacific Northwest markets were dysfunctional, that rates for spot market sales were unjust and unreasonable and that the imposition of refunds would be appropriate. In September 2001, the FERC's Administrative Law Judge presiding over the evidentiary hearing issued a decision favorable to the Company's position and recommended that the FERC not order refunds and instead dismiss the entire proceeding. In June 2003, the FERC terminated the Pacific Northwest refund proceedings, after finding that the equities do not justify the imposition of refunds. In November 2003, the FERC affirmed its order. 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. Oral arguments are expected, but have not yet been set, during the fourth quarter of 2005. 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. 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.

Reliant Energy, Inc. and Duke Energy Corporation Cross-Complaints

In April 2002, several subsidiaries of Reliant Energy, Inc. (Reliant) and Duke Energy Corporation (Duke) filed cross-complaints against Avista Energy and numerous other participants in the California energy markets. The cross-complaints seek indemnification for any liability that may arise from original complaints filed against Reliant and Duke with respect to charges of unlawful and unfair business practices in the California energy markets under California law. In June 2002, Avista Energy filed motions to dismiss the cross-complaints. In the meantime, the U.S. District Court remanded the case to California State Court, which remand is itself the subject of an appeal to the United States Court of Appeals for the Ninth Circuit. In December 2004, the Ninth Circuit issued its opinion affirming the U.S. District Court's remand of these cases to California State Court, and a rehearing request was denied on March 3, 2005. On March 10, 2005, the Ninth Circuit's mandate, remanding the case to state court, was issued. Cross-defendant Powerex Corp. filed a motion to recall mandate, asking that the Ninth Circuit recall its mandate until a petition for certiorari seeking review of this case by the United States Supreme Court is filed and ruled upon by the Supreme Court. In April 2005, the Ninth Circuit denied Powerex Corp.'s motion to recall mandate, and the case has been remanded to the California State Court. In June 2005, the cross-defendants, including Avista Energy, filed a demurrer in the California State Court seeking to dismiss the action. Further briefing and hearing on the demurrer is currently stayed pending the outcome of the demurrers filed by Duke and Reliant on the main complaint, which is currently set to be heard in September 2005. At this time, the Company cannot predict the outcome of the cross-complaints or the original complaints filed against Reliant and Duke or provide an estimate of any potential liability to Avista Energy with respect to the cross-complaints. However, 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. 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.

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 were liable for sales of energy at rates that were "unjust and unreasonable." 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 Ninth Circuit has yet to rule on the request for rehearing. 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. 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.

Port of Seattle Complaint

In May 2003, a complaint was originally filed by the Port of Seattle in the United States District Court for the Western District of Washington against numerous companies, including Avista Corp., Avista Energy, Inc. and Avista Power, LLC (collectively the Avista defendants), seeking compensatory and treble damages for alleged violations of the Sherman Act and the Racketeer Influenced and Corrupt Organization Act by transmitting, via wire communications, false information intended to increase the price of power, knowing that others would rely upon such information. The complaint alleged that the defendants and others knowingly devised and attempted to devise a scheme to defraud and to obtain money and property from electricity customers throughout the Western Electricity Coordinating Council (WECC), by means of false and fraudulent pretenses, representations and promises. The alleged purpose of the scheme was to artificially increase the price that the defendants received for their electricity and ancillary services, to receive payments for services they did not provide and to manipulate the price of electricity throughout the WECC. In August 2003, the Avista defendants filed a motion to dismiss this complaint. A transfer order was granted, which moved this case to the United States District Court for the Southern District of California to consolidate it with other pending actions. Arguments with respect to the motions to dismiss filed by the Avista defendants and other defendants were heard on March 26, 2004. On May 12, 2004, the United States District Court for the Southern District of California granted motions to dismiss filed by the Avista defendants, as well as other defendants, with respect to this complaint. The Court dismissed the complaint because it determined that it was without jurisdiction to hear the plaintiff's claims, based on, among other things, the exclusive jurisdiction of the FERC and the filed-rate doctrine. On May 27, 2004, the Port of Seattle filed an appeal with the United States Court of Appeals for the Ninth Circuit. This matter has been briefed and awaits oral argument. 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. 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.

Wah Chang Complaint

On May 5, 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. The complaint 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 October 2004, the Avista defendants joined with other defendants in filing a joint motion to dismiss the complaint. In February 2005, the Court dismissed 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. On May 17, 2005, Wah Chang moved for an order staying the appeal, or dismissing it without prejudice to reinstatement, arguing that the disposition of its appeal was linked to the outcome of a petition for certiorari to the United States Supreme Court filed by Public Utility District No. 1 of Snohomish County (see discussion below) and the resolution of the Port of Seattle complaint (see discussion above). On May 25, 2005, the defendants filed an objection to the Wah Chang's motion and filed their own cross-motion for Summary Affirmance of the District Court's decision to dismiss. Wah Chang responded to the cross-motion in June 2005 and the motions were denied by the United States Court of Appeals for the Ninth Circuit in July 2005. 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. 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.

City of Tacoma Complaint

On June 7, 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 seeks compensatory and treble damages from alleged violations of the Sherman Act. Tacoma Power alleges 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. 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. 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.

Public Utility District No. 1 of Snohomish County

On June 27, 2005, the United States Supreme Court denied a Petition For a Writ of Certiorari filed by Public Utility District No. 1 of Snohomish County (Snohomish PUD). Although this case did not directly involve Avista Corp. and its subsidiaries, the outcome could have a bearing on pending litigation and regulatory proceedings affecting Avista Corp. and its subsidiaries discussed above, particularly issues pending before the United States Court of Appeals for the Ninth Circuit. Snohomish PUD filed the petition with the United States Supreme Court on November 5, 2004, which requested the Court to consider whether the filed rate doctrine applies for market-based rates so as to preempt state law antitrust and consumer fraud actions based upon alleged fraud and manipulation of electricity markets operated under market-based rate tariffs. This petition was seeking United States Supreme Court review of the decision of the United States Court of Appeals for the Ninth Circuit on September 10, 2004, which held that the filed rate doctrine and field and conflict preemptions bar such actions.

State of Montana Proceedings

On June 30, 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. On February 12, 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. 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.

Montana Public School Trust Fund Lawsuit

In October 2003, a lawsuit was filed by Richard Dolan and Denise Hayman 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 alleges that the hydroelectric facilities are located on state-owned riverbeds and the owners 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. An Amended Complaint adding Great Falls Elementary School District No. 1 and Great Falls High School District No. 1A was filed on January 16, 2004. On February 2, 2004, the Company filed its motion to dismiss this lawsuit; PacifiCorp and PPL Montana, as the other named defendants also filed a motion to dismiss, or joined therein. On May 10, 2004, the Montana AG filed a complaint on behalf of the state to join in this lawsuit to allegedly protect and preserve state lands/school trust lands from use without compensation. On July 19, 2004, the defendants (including Avista Corp.) filed a motion to dismiss the Montana AG's complaint. On September 29, 2004, the United States District Court granted the motion to dismiss filed with respect to plaintiffs Richard Dolan, Denise Hayman and the school districts. However, the motion to dismiss the Montana AG's complaint was denied, citing, among other things, that the FERC does not have exclusive jurisdiction over this matter. Subsequently, in response to the motions of the defendants, the federal magistrate judge on January 19, 2005 filed recommendations that the Court's previous decision be vacated based on lack of jurisdiction of the Court. On November 12, 2004, the defendants (including Avista Corp.) filed a petition for declaratory relief in Montana State Court requesting the resolution of the controversy that the plaintiffs raised in federal court. On November 24, 2004, the Montana AG filed an answer, counterclaim and motion for summary judgment. The defendants have filed responses to the Montana AG's motion for summary judgment. On June 8, 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 with the State of Montana relating to the relicensing of Avista Corp.'s Noxon Rapids Hydroelectric Generating Project. On June 28, 2005, the Montana State Court heard the motion of summary judgment of the Montana AG and took the matter under advisement. 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. 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.

Colstrip Generating Project Complaint

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. 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.

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 alleges that Colstrip Units 3 & 4 have been in violation of the CAA permit at Colstrip since 1980. 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 is asserting that regulations it promulgated in 1980 triggered this requirement. Avista Utilities and PPL Montana, LLC believe that the ACO is unfounded and PPL Montana, LLC is discussing the matter with the EPA. The ACO does not expressly seek penalties, and it is unclear at this time what, if any, additional control technology the EPA may consider to be required. Accordingly, the costs to install any additional controls for nitrogen oxides, if required, cannot be estimated at this time. The owners of Colstrip are engaged in settlement negotiations on these matters with the EPA, the Department of Environmental Quality (Montana DEQ) and the Northern Cheyenne Tribe. Because the resolution of these issues 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 issues will have a material adverse effect 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.

In addition, the Montana DEQ questioned whether the permit limits for sulfur dioxide emissions from Colstrip Units 3 & 4 were too high under provisions of the CAA that limit allowable emissions from sources built after 1978. PPL Montana, LLC, completed an ambient air quality modeling demonstration and, based on that study, voluntarily proposed to the Montana DEQ that the permit include restrictions related to sulfur dioxide emissions. The Montana DEQ has accepted this proposal and has issued an amended operating permit and issued an amended air permit, which the owners of Colstrip believe will resolve this matter with respect to the Montana DEQ.

Colstrip Royalty Claim

The Western Energy Company (WECO) supplies coal to the owners of Colstrip Units 3 & 4 under a Coal Supply Agreement and a Transportation Agreement. 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 (approximately 4.46 miles long). The owners of Colstrip Units 3 & 4 take delivery of the coal at the western end (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. Because the resolution of this issue 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 issue will have a material adverse effect 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.

Hamilton Street Bridge Site

A portion of the Hamilton Street Bridge Site in Spokane, Washington (including a former coal gasification plant site that operated for approximately 60 years until 1948) was acquired by the Company through a merger in 1958. The Company no longer owns the property. In January 1999, the Company received notice from the State of Washington's Department of Ecology (DOE) that it had been designated as a potentially liable party (PLP) with respect to any hazardous substances located on this site, stemming from the Company's past ownership of the former gas plant site. In its notice, the DOE stated that it intended to complete an on-going remedial investigation of this

site, complete a feasibility study to determine the most effective means of halting or controlling future releases of substances from the site, and to implement appropriate remedial measures. The Company responded to the DOE acknowledging its listing as a PLP, but requested that additional parties also be listed as PLPs. In the spring of 1999, the DOE named two other parties as additional PLPs.

The DOE, the Company and another PLP, Burlington Northern & Santa Fe Railway Co. (BNSF), signed an Agreed Order in March 2000 that provided for the completion of a remedial investigation and a feasibility study. The work to be performed under the Agreed Order includes three major technical parts: completion of the remedial investigation; performance of a focused feasibility study; and implementation of an interim groundwater monitoring plan. During the second quarter of 2000, the Company received comments from the DOE on its initial remedial investigation, and then submitted another draft of the remedial investigation, which was accepted as final by the DOE. After responding to comments from the DOE, the feasibility study was accepted by the DOE during the fourth quarter of 2000. After receiving input from the Company and the other PLPs, the final Cleanup Action Plan (CAP) was issued by the DOE in August 2001. In September 2001, the DOE issued an initial draft Consent Decree for the PLPs to review. During the first quarter of 2002, the Company and BNSF signed a cost sharing agreement. In September 2002, the Company, BNSF and the DOE finalized the Consent Decree to implement the CAP. The third PLP has indicated it will not sign the Consent Decree. It is currently estimated that the Company’s share of the costs will be less than $1.0 million. The Engineering and Design Report for the CAP was submitted to the DOE in January 2003 and approved by the DOE in May 2003. Work under the CAP commenced during the second quarter of 2003. In September 2004, a Site Preparation Agreement was reached with the third PLP with respect to the logistics of the CAP. The third PLP has completed the site preparation; work under the CAP as directed by the Company and BNSF is expected to be completed by the end of 2005.

Spokane River

In March 2001, the DOE informed Avista Development, a subsidiary of Avista Capital, of a health advisory concerning PCBs found in fish caught in a portion of the Spokane River. In June 2001, Avista Development received official notice that it had been designated as a PLP with respect to contaminated sites on the Spokane River. The DOE discovered PCBs in fish and sediments in the Spokane River in the 1970s and 1980s. In the 1990s, the DOE performed subsequent sampling of the river and identified potential sources of the PCBs, including the Spokane Industrial Park (SIP) and a number of other entities in the area. The SIP, renamed Pentzer Development Corporation (Pentzer Development) in 1990, operated a wastewater treatment plant at the site until it was closed in December 1993. The SIP’s treatment plant discharged to the Spokane River under the terms of a National Pollutant Discharge Elimination System permit issued by the DOE. Pentzer Development sold the property in 1996 and merged with Avista Development in 1998. Avista Development filed a response to this notice in August 2001. In December 2001, the DOE confirmed Avista Development’s status as a PLP and named at least two other PLPs in this matter. In April 2003, the DOE released its study of wastewater and sludge handling from facilities owned by a fourth PLP. The DOE study indicated that the fourth PLP continued to discharge PCBs into the Spokane River. The DOE issued the fourth PLP a final notice of participation as a PLP on April 30, 2003.

During the fourth quarter of 2002, Avista Development and one other PLP, Kaiser Aluminum & Chemical Corporation (Kaiser), finalized the Consent Decree and Scope of Work for the remedial investigation and feasibility study of the site, which was formally entered into Spokane County Superior Court in January 2003. The other PLPs have not been participating in the process. As directed by Avista Development and Kaiser, the field-work for the remedial investigation began in April 2003 and was completed by the end of 2003 with a draft remedial investigation report and feasibility study technical memorandum submitted to the DOE in March 2004. In December 2004, the Company and Kaiser filed the draft final remedial investigation and feasibility study with the DOE. In March 2005, the DOE issued its draft Cleanup Action Plan (CAP), which was materially consistent with the draft final feasibility study filed by the Company and Kaiser. The draft CAP was open for public review and comment, along with the draft final remedial investigation and feasibility study and the state cleanup consent decree until May 6, 2005. Based on public comments received, the DOE has only made minor modifications to the draft CAP, remedial investigation and feasibility study.

The Company has entered into a tentative settlement with the DOE and Kaiser relating to the remediation of the site. Under the tentative agreement, the Company will perform the selected remedial action. Kaiser, which is presently operating under bankruptcy protection, has agreed to pay the Company approximately 50 percent of the current estimate of the total costs, which will be used by the Company to fund the costs of the remediation. On June 27, 2005, the Kaiser bankruptcy judge signed an order approving Kaiser’s motion to enter into a consent decree for settlement with the Company and the State of Washington. During 2004, the Company accrued its share of the total estimated costs, which was not material to the Company’s consolidated financial condition or results of operations.

Because of uncertainties with respect to, among other things, any future cost sharing agreement with the non-participating PLPs, Kaiser's bankruptcy, the final cleanup action plan required by the DOE and 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. It is possible that a change could occur in the Company's estimate of the liability. Such a change, should it occur, could be significant.

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 1980's and early 1990's. On June 29, 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 Corporation, Northwestern Energy and Unocal Oil. The notice invites all named parties to meet among themselves within 60 days from the June 29, 2005 notice date for purposes of forming a steering committee and entering into an Agreed Order with the EPA to conduct a remedial investigation and feasibility study.

The Company is in the process of gathering and reviewing all records related to Harbor Oil. Based on the review to this point, 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 currently 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 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 a present capability of 18 MW, 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 with respect 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. However, the Company intends to seek recovery of any amounts paid through the rate making process.

Spokane River Relicensing

The Company operates six hydroelectric plants on the Spokane River, and five of these (Long Lake, Nine Mile, Upper Falls, Monroe Street and Post Falls) are under one FERC license and referred to herein 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 license application with the FERC in July 2005. The Company has requested the FERC to consider a separate license for Post Falls from the other four hydroelectric plants. This is due to the fact that 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 application, the Company has proposed a number of measures intended to address the

impact of the Spokane River Project and enhance resources associated with the Spokane River. Currently, certain environmental measures in the Company's license application have estimated costs of $3.2 million per year. For certain items, costs cannot be reasonably estimated at this time. 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 over the next two years. The Company intends to seek recovery of relicensing costs through the rate making process.

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 submitted the Gas Supersaturation Control Program (GSCP) in December 2002 for review and approval to the Idaho Department of Environmental Quality (DEQ) and the U.S. Fish and Wildlife Service. In February 2004, the Idaho DEQ and the U.S. Fish and Wildlife Service approved the GSCP. In January 2005, the FERC issued an order approving the GSCP. 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. Streamflows would be diverted to the tunnels when these flows are in excess of turbine capacity. The cost of modifying the first tunnel is currently preliminarily estimated to be $38 million (including AFUDC and inflation) and will be incurred between 2004 and 2010 ($0.6 million incurred through June 30, 2005), with the majority of these costs being incurred in 2007 through 2009. The second tunnel would be modified only after evaluation of the performance of the first tunnel and such modifications would commence no later than 10 years following the completion of the first tunnel. It is currently preliminarily estimated that the costs to modify the second tunnel would be $26 million (including AFUDC and inflation). As part of the GSCP, the Company provides $0.5 million annually as mitigation for aquatic resources that might be adversely affected by high dissolved gas levels. Mitigation funds will continue until the modification of the second tunnel commences or if the second tunnel is not modified to an agreed upon point in time commensurate with the biological effects of high dissolved gas levels. The Company intends to seek recovery of the costs for the modification of Cabinet Gorge and the mitigation payments through the rate making process.

The operating license for the Clark Fork Project describes the approach to restore bull trout populations in the project areas. Using the concept of adaptive management and working closely with the U.S. Fish and Wildlife Service, the Company is evaluating the feasibility of fish passage. 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 fish population enhancement measures.

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 the Company's 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.

The Company's collective bargaining agreement with the International Brotherhood of Electrical Workers represents approximately 50 percent of all Avista Utilities employees. The agreement with the local union in Washington and Idaho representing the majority (approximately 90 percent) of the bargaining unit employees expired on March 25, 2005. Two local agreements in Oregon, which cover approximately 50 employees, expired on March 31, 2005. On August 5, 2005, new local agreements were approved that expire in March 2007 in Washington and Idaho, and April 2010 in Oregon.

NOTE 12. DISPOSITION OF SOUTH LAKE TAHOE PROPERTIES

In April 2005, Avista Corp. completed the sale of its South Lake Tahoe, California natural gas distribution properties to Southwest Gas Corporation as part of Avista Utilities' strategy to focus on its business in the northwestern United States. This was the Company's only regulated utility operations in California. The cash proceeds received were approximately $15.6 million, which resulted in a pre-tax gain of $3.2 million.

Total revenues for 2004 from the South Lake Tahoe region were approximately $20.3 million (or 6 percent of total natural gas revenues) and approximately 22.1 million therms (or 4 percent of total therms) were delivered to South Lake Tahoe customers.

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The Company classified the assets of its South Lake Tahoe natural gas distribution properties as assets held for sale on the Consolidated Balance Sheets as of December 31, 2004. These assets consisted primarily of net utility property, accounts receivable and deferred natural gas costs.

NOTE 13. 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. Avista Advantage is a provider of utility bill processing, payment and information services to 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	Avista Advantage	Other	Intersegment Eliminations (1)	Total
For the three months ended June 30, 2005:						
Operating revenues	$ 238,319	$ 22,026	$ 7,703	$ 4,784	$ —	$ 272,832
Resource costs	112,722	18,253	—	—	—	130,975
Gross margin	125,597	3,773	—	—	—	129,370
Other operating expenses:						
Operations and maintenance	25,859	—	3,540	3,917	—	33,316
Administrative and general	18,425	4,231	1,884	539	—	25,079
Depreciation and amortization	19,843	355	501	689	—	21,388
Income (loss) from operations	48,903	(973)	1,658	(369)	—	49,219
Interest expense (2)	22,655	65	236	389	(517)	22,828
Income taxes	9,766	(126)	509	(227)	—	9,922
Net income (loss)	18,407	(250)	918	(471)	—	18,604
Capital expenditures	31,817	543	430	322	—	33,112
For the three months ended June 30, 2004:						
Operating revenues	200,147	43,069	5,500	4,665	(27,493)	225,888
Resource costs	87,124	35,865	—	—	(27,493)	95,496
Gross margin	113,023	7,204	—	—	—	120,227
Other operating expenses:						
Operations and maintenance	26,763	—	2,720	3,793	—	33,276
Administrative and general	16,676	4,804	2,675	614	—	24,769
Depreciation and amortization	19,179	341	460	651	—	20,631
Income (loss) from operations	35,696	1,780	(355)	(534)	—	36,587
Interest expense (2)	23,316	151	209	280	(397)	23,559
Income taxes	5,391	902	(188)	(97)	—	6,008
Net income (loss)	9,090	1,504	(350)	(112)	—	10,132
Capital expenditures	26,639	287	226	164	—	27,316
Total Assets:						
Total assets as of June 30, 2005	2,724,450	1,176,074	47,765	47,565	—	3,995,854
Total assets as of December 31, 2004	2,602,715	1,002,843	47,318	53,305	—	3,706,181

(1) Intersegment eliminations reported as operating revenues and resource costs represent the transactions between Avista Utilities and Avista Energy for energy commodities and services, primarily natural gas purchased by Avista Utilities under the Agency Agreement. Intersegment eliminations reported as interest expense represent intercompany interest.

(2) Including interest expense to affiliated trusts.

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	Avista Utilities	Energy Marketing And Resource Management	Avista Advantage	Other	Intersegment Eliminations (1)	Total
For the six months ended June 30, 2005:						
Operating revenues	$558,035	$ 73,315	$ 14,943	$ 8,632	$ (19,429)	$ 635,496
Resource costs	294,435	78,126	—	—	(19,429)	353,132
Gross margin	263,600	(4,811)	—	—	—	258,789
Other operating expenses:						
Operations and maintenance	53,032	285	7,014	7,715	—	68,046
Administrative and general	36,183	8,507	3,564	1,080	—	49,334
Depreciation and amortization	41,021	792	1,000	1,281	—	44,094
Income (loss) from operations	100,509	(14,781)	3,134	(1,460)	—	87,402
Interest expense (2)	45,726	137	467	751	(975)	46,106
Income taxes	21,295	(4,620)	950	(873)	—	16,752
Net income (loss)	37,393	(8,608)	1,726	(1,718)	—	28,793
Capital expenditures	115,300	752	531	662	—	117,245
For the six months ended June 30, 2004:						
Operating revenues	490,151	146,786	10,787	8,579	(86,683)	569,620
Resource costs	255,768	129,676	—	—	(86,683)	298,761
Gross margin	234,383	17,110	—	—	—	251,493
Other operating expenses:						
Operations and maintenance	54,017	—	5,534	7,468	—	67,019
Administrative and general	34,722	9,466	4,459	1,618	—	50,265
Depreciation and amortization	35,415	688	968	1,242	—	38,313
Income (loss) from operations	75,356	6,498	(175)	(1,885)	—	79,794
Interest expense (2)	46,587	369	419	631	(818)	47,188
Income taxes	13,496	2,840	(198)	(1,000)	—	15,138
Net income (loss) before cumulative effect of accounting change	19,906	5,034	(367)	(1,757)	—	22,816
Net income (loss)	19,906	5,034	(367)	(2,217)	—	22,356
Capital expenditures	46,528	567	179	458	—	47,732

(1) Intersegment eliminations reported as operating revenues and resource costs represent the transactions between Avista Utilities and Avista Energy for energy commodities and services, primarily natural gas purchased by Avista Utilities under the Agency Agreement. Intersegment eliminations reported as interest expense represent intercompany interest.

(2) Including interest expense to affiliated trusts.

AVISTA CORPORATION

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

Forward-Looking Statements

Avista Corp. from time to time makes forward-looking statements such as statements regarding future financial performance, capital expenditures, dividends, capital structure and other financial items, including the underlying assumptions (many of which are based, in turn, upon further assumptions), as well as strategic goals and objectives and plans for future operations. Such statements are made both in Avista Corp.'s 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 other than statements of historical fact, including, without limitation, those that are identified by the use of words such as, but not limited to, "will," "may," "could," "should," "intends," "plans," "seeks," "anticipates," "estimates," "expects," "projects," "predicts," and similar expressions.

All forward-looking statements (including those made in this Quarterly Report) are subject to a variety of risks and uncertainties and other factors, most of which are beyond the control of Avista Corp. and many of which could have a significant impact on Avista Corp.'s operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements. Such risks, uncertainties and other factors include, among others:

- 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 the utility regulatory environment in the individual states and provinces in which the Company operates as well as the United States and Canada in general, which can impact allowed rates of return, financings, or industry and rate structures;
- the impact of regulatory decisions including FERC price controls, and including possible retroactive price caps and resulting refunds;
- the potential effects of any legislation or administrative rulemaking passed into law, including any energy-related legislation passed into law by the United States Congress or the individual states in which the Company operates;
- the impact from the potential formation of a Regional Transmission Organization;
- the ability to relicense the Spokane River Project at a cost-effective level with reasonable terms and conditions;
- volatility and illiquidity in wholesale energy markets, including the availability and prices of purchased energy and demand for energy sales;
- changes in wholesale energy prices that can affect, among other things, the market value of derivative assets and liabilities and unrealized gains and losses, as well as cash requirements to purchase electricity and natural gas for retail customers;
- changes in global energy markets that can affect, among other things, the price of natural gas purchased for retail customers and purchased as fuel for electric generation;
- wholesale and retail competition (including, but not limited to, electric retail wheeling and transmission costs);
- unplanned outages at any Company-owned generating facilities;
- unanticipated delays or changes in construction costs with respect to present or prospective facilities;
- natural disasters that can disrupt energy delivery;
- blackouts or large disruptions of transmission systems, which can have an impact on the Company's ability to deliver energy to its customers;
- changes in industrial, commercial and residential growth and demographic patterns in the Company's service territory;
- the loss of significant customers and/or suppliers;
- failure to deliver on the part of any parties from which the Company purchases and/or sells capacity or energy;
- changes in the creditworthiness of customers and energy trading counterparties;
- the Company's ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including the Company's credit ratings, interest rate fluctuations and other capital market conditions;
- the impact of any potential change in the Company's credit ratings;
- changes in future economic conditions in the Company's service territory and the United States in general, including inflation or deflation and monetary policy;
- changes in rapidly advancing technologies, possibly making some of the current technology quickly obsolete;
- the potential for future terrorist attacks, particularly with respect to utility plant assets;
- changes in tax rates and/or policies;
- changes in, and compliance with, environmental and endangered species laws, regulations, decisions and policies, including present and potential environmental remediation costs;

- the outcome of legal and regulatory proceedings concerning the Company or affecting directly or indirectly its operations, including the potential disallowance of previously deferred costs;
- employee issues, including changes in collective bargaining unit agreements, strikes, work stoppages or the loss of key executives, as well as the ability to recruit and retain employees;
- changes in actuarial assumptions, the interest rate environment and the actual return on plan assets with respect to the Company's pension plan, which can impact future funding obligations, costs and pension plan liabilities;
- increasing health care costs and the resulting effect on health insurance premiums paid for employees and on the obligation to provide postretirement health care benefits; and
- increasing costs of insurance, changes in coverage terms and the ability to obtain insurance.

The Company's expectations, beliefs and projections are expressed in good faith and are believed by the Company to have a reasonable basis including, without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties. However, there can be no assurance that the Company's 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. The Company undertakes 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 management to predict all of such factors, nor can it assess the impact of each such factor on the Company's 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 the Company's financial condition and results of operations and should be read along with the consolidated financial statements.

Avista Corp. Business Segments

Avista Corp. is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. The Company has four business segments – Avista Utilities, Energy Marketing and Resource Management, Avista Advantage and Other. Avista Utilities is an operating division of Avista Corp. comprising the regulated utility operations. Avista Utilities generates, transmits and distributes electricity and distributes natural gas. 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. As of June 30, 2005, the Company had common equity investments of $529.8 million and $235.4 million in Avista Utilities and Avista Capital, respectively.

The Energy Marketing and Resource Management business segment is comprised of Avista Energy, Inc. (Avista Energy) and Avista Power, LLC (Avista Power). Avista Energy is an electricity and natural gas marketing, trading and resource management business, operating primarily in the Western Electricity Coordinating Council (WECC) geographical area, which is comprised of eleven Western states and the provinces of British Columbia and Alberta, Canada. Avista Power is an investor in certain generation assets, primarily its 49 percent interest in a 270 MW natural gas-fired combined cycle combustion turbine plant in northern Idaho (Lancaster Project).

Avista Advantage, Inc. (Avista Advantage) is a provider of utility bill processing, payment and information services to multi-site customers throughout North America. Its primary product lines include consolidated billing, resource accounting, energy analysis and load profiling services.

The Other business segment includes Avista Ventures, Inc. (Avista Ventures), Pentzer Corporation (Pentzer), Avista Development and certain other operations of Avista Capital. Included in this business segment is Advanced Manufacturing and Development (AM&D) doing business as METALfx, a subsidiary of Avista Ventures that performs custom sheet metal manufacturing of electronic enclosures, parts and systems for the computer, telecom and medical industries. AM&D also provides complete fabrication and turnkey assembly for arcade games, kiosks, store fixtures and displays. Other significant investments in this segment include commercial office buildings, investments in low income housing and venture capital partnerships, the remaining investment in a previous fuel cell subsidiary of the Company, and notes receivable from the sale of property and investments.

AVISTA CORPORATION

Executive Level Summary

Avista Corp.'s operating results and cash flows are derived primarily from Avista Utilities and Avista Energy (included in the Energy Marketing and Resource Management segment). Avista Corp. intends 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.

Avista Utilities expects to continue to be among the industry leaders in performance, value and service in its electric and natural gas utility businesses. Avista Utilities expects to continue its modest, yet steady, combined growth of electric and natural gas customers of 2 to 3 percent per year primarily from economic and population growth in its service territory. As part of Avista Utilities' strategy to focus on its business in the northwestern United States, in April 2005, the Company completed the sale of its natural gas distribution properties in South Lake Tahoe, California (see "Note 12 of the Notes to Consolidated Financial Statements"). This was the Company's only regulated utility operations in California.

It is Avista Utilities' strategy to own or to have contracts that provide a sufficient amount of electric resources to meet its retail and wholesale energy requirements under a range of operating conditions. The availability of Avista Utilities' hydroelectric generation is significantly affected by precipitation, temperatures and other variables. Avista Utilities' hydroelectric generation was 95 percent of normal in 2004. Based on forecasts as of July 2005, Avista Utilities expects hydroelectric generation will be approximately 94 percent of normal in 2005 based upon the forecast of below normal precipitation and streamflows for the remainder of the year. This forecast may change based upon precipitation, temperatures and other variables. The earnings impact of below normal hydroelectric generation is mitigated by power cost deferral and recovery mechanisms in Washington and Idaho. As such, the expected reduction in hydroelectric generation is not expected to have a significant negative effect on operating cash flows or earnings for 2005 from the amount originally forecasted. Including the forecast for 2005, hydroelectric generation has been below normal for 5 of the past 6 years. The Company cannot determine if this trend of lower than normal hydroelectric generation will continue in future years.

Customer loads and resulting revenues are also significantly affected by weather, which causes changes in energy usage from season to season and from month to month within a season. Avista Utilities normally experiences its highest retail energy sales during the heating season in the first and fourth quarters of the year. Total heating degree days at Spokane, Washington for the six months ended June 30, 2005 (92 percent of normal) were less than the six months ended June 30, 2004 (94 percent of normal). As such, electric and natural gas loads and revenues were negatively affected by weather when comparing year-to-date results for 2005 and 2004.

As is the case with most regulated entities, Avista Utilities generally has ongoing regulatory proceedings. Avista Utilities received the following base rate increases in 2004 and 2005: Idaho electric and natural gas in September 2004; Washington natural gas in November 2004; and Idaho electric in April 2005 for the addition of the remaining interest in Coyote Springs 2. The base rate increases implemented in 2004 have increased revenues and net income for the three and six months ended June 30, 2005 as compared to the three and six months ended June 30, 2004 and should result in increased net income for the full year of 2005 as compared to 2004. In March 2005, Avista Utilities filed a request with the WUTC to increase its base electric and natural gas rates. Avista Utilities will continue to file for rate adjustments to provide for recovery of its costs and to more closely align earned returns with those allowed by regulatory agencies in each jurisdiction.

Avista Utilities' net income increased for the six months ended June 30, 2005 as compared to the six months ended June 30, 2004 primarily due to the general rate increases, the benefit of lower electric resource costs in 2005 under the Washington Energy Recovery Mechanism (ERM) dead band as compared to the expense of higher electric resource costs in 2004, as well as the gain on the sale of the South Lake Tahoe natural gas distribution properties. This was partially offset by decreased use per customer in the Washington and Idaho service territories as a result of warmer weather during the first quarter. The Company expects Avista Utilities' net income for 2005 to increase as compared to 2004 primarily due to the continued effect of general rate increases, subject to the influence of weather. However, the third quarter is typically a weak quarter for Avista Utilities, and results for the third quarter of 2005 may be reduced more than normal by higher electric resource costs. This is due to the anticipated reduction in hydroelectric generation, higher fuel costs and the expected absorption of the $9.0 million dead band under the ERM in Washington that is expected to result in an expense of $9.7 million due to the reversal of the $0.7 million benefit received for the first half of 2005 under the ERM methodology.

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The Company has management succession plans that work towards ensuring that executive officer and key management positions can be appropriately filled as vacancies occur. The Company has taken similar steps in key technical and craft areas.

Avista Energy focuses on 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 is also involved in trading electricity and natural gas, including derivative commodity instruments. Avista Energy Canada, Ltd. (Avista Energy Canada) is a wholly owned subsidiary of Avista Energy that provides natural gas services to approximately 250 industrial and commercial customers that represent over 400 sites in British Columbia, Canada. In addition to earnings and resulting cash flows from settled or realized transactions, Avista Energy records unrealized or mark-to-market adjustments for the change in the value of derivative commodity instruments. Avista Energy's marketing, trading and resource management activities are driven by its base of knowledge and experience in the operation of both electric energy and natural gas physical systems in the WECC, as well as its relationship-focused approach with its customers.

Avista Energy is subject to certain regulatory proceedings that remain unresolved; however, Avista Energy believes that it has adequate reserves established for refunds that may be ordered. The wholesale power markets in which Avista Energy operates continue to change with respect to market participants involved, level of activity, volatility in market prices, liquidity, regulatory imposed price caps and counterparty credit issues.

Avista Energy and the Energy Marketing Resource Management segment incurred a net loss for the six months ended June 30, 2005 compared to net income for the six months ended June 30, 2004. This net loss for the first half of 2005 was primarily related to losses in Avista Energy's natural gas portfolio. However, the Company expects the Energy Marketing and Resource Management segment to have positive net income for the second half of 2005.

Avista Advantage remains focused on increasing revenues, controlling operating expenses, continuously enhancing client satisfaction and developing complementary value-added services in a competitive market. During the first quarter of 2005, Avista Advantage acquired TelAssess, Inc. Although not a significant financial transaction, this acquisition provides Avista Advantage a foundation on which to expand beyond utility bill information services to provide similar services relating to telecom billing. The Company expects that net income for Avista Advantage for 2005 will increase as compared to 2004 based on increased revenues and stabilizing operating expenses from processing efficiencies.

Over time as opportunities arise, the Company plans to continue to dispose of assets and phase out operations in the Other business segment. The Company expects the net loss in the Other business segment to be less for fiscal year 2005 as compared to 2004 primarily due to decreased losses from asset impairments and write-offs.

During the six months ended June 30, 2005, positive cash flows from operations, proceeds from the sale of the Company's South Lake Tahoe natural gas distribution properties and an overall reduction in the Company's consolidated cash position were used to fund the majority of Avista Corp.'s cash requirements, including utility capital expenditures and dividends. During the remainder of 2005, the Company expects cash flows from operations and Avista Corp.'s five-year $350.0 million committed line of credit to provide adequate resources to fund capital expenditures, maturing long-term debt (excluding $54.6 million of WP Funding LP debt maturing in October 2005) and other contractual commitments. The Company is evaluating its options with respect to the $54.6 million of maturing WP Funding LP debt and expects to ultimately refinance the debt on a long-term basis. However, the Company plans to fund the maturing debt with its committed line of credit on an interim basis. If market conditions warrant such actions, Avista Corp. may also issue additional long-term debt beyond the amount required to fund maturing WP Funding LP debt.

Avista Utilities – Electric Resources

As of June 30, 2005, Avista Utilities' facilities had a total net capability of approximately 1,800 MW, of which 54 percent was hydroelectric and 46 percent was thermal. In addition to company owned resources, Avista Utilities has a number of long-term power purchase and exchange contracts that increase its available resources. See "Note 5 of the Notes to Consolidated Financial Statements" for information with respect to Avista Utilities' resource optimization process.

Avista Utilities – Regulatory Matters

General Rate Cases

Avista Utilities regularly reviews the need for electric and natural gas rate changes in each state in which it provides service.

On March 30, 2005, Avista Utilities filed a request with the WUTC to increase its base electric rates by 12.5 percent and its base natural gas rates by 1.8 percent. This request is designed to increase its annual electric and natural gas revenues by $35.8 million and $2.9 million, respectively. Avista Utilities' request is based on a proposed rate of return of 9.67 percent, including a return on common equity of 11.5 percent with an authorized equity level of 44 percent. In the general rate case filing, Avista Utilities has also requested modification of the ERM as described at "Power Cost Deferrals and Recovery Mechanisms" below. The WUTC has up to 11 months from the date of filing to review the general rate case. Based on the current schedule established by the WUTC, the Company expects a final decision by the end of January 2006.

In January 2005, the WUTC issued its final order with respect to a natural gas general rate case filed by Avista Utilities in Washington. The final order authorized, among other things, an increase in natural gas rates of 3.9 percent, which is designed to increase annual revenues by $5.4 million. The final order authorized an overall rate of return of 8.68 percent. The natural gas rate increase was implemented in November 2004 resulting from a settlement agreement reached among the Company, the staff of the WUTC and the Northwest Industrial Gas Users in October 2004. The increase was approved by the WUTC in November 2004 on a "subject to refund" basis to allow the non-settling parties the opportunity to further review the case.

In October 2004, the IPUC issued its final order with respect to electric and natural gas general rate cases filed by Avista Utilities in Idaho. The final order authorized, among other things, Avista Utilities to increase its electric base rates by 16.9 percent, which is designed to increase annual revenues by $24.7 million, and increase its natural gas base rates by 6.4 percent, which is designed to increase annual revenues by $3.3 million. Due to a decrease implemented concurrently in Avista Utilities' power cost adjustment (PCA) surcharge and certain other minor adjustments, the net increase in electric rates for Idaho customers was 1.9 percent above rates in effect at that time. The decrease in the PCA surcharge reduces the rate increase impact to customers and extends the period for recovery of deferred power costs. The final order authorized an overall rate of return of 9.25 percent, including a return on common equity of 10.4 percent based on an authorized equity level of approximately 43 percent.

Other Regulatory Filings

In April 2005, the IPUC issued an order approving the inclusion of the remaining 50 percent of Coyote Springs 2 in base electric rates. The order provides for a 1.9 percent increase in base electric rates, which is designed to increase annual revenues by $3.2 million. At the same time, the IPUC approved a 1.9 percent reduction in the Company's current PCA rate surcharge, which extends the two-year recovery period of deferred power costs by an additional year. These two requests together resulted in no overall change to customers' existing rates.

Power Cost Deferrals and Recovery Mechanisms

Avista Utilities defers the recognition in the income statement of certain power supply costs that are in excess of the level currently recovered from retail customers as authorized by the WUTC and the IPUC. A portion of power supply costs are recorded as a deferred charge on the Consolidated Balance Sheets for future review and the opportunity for recovery through retail rates.

In Washington, the ERM allows Avista Utilities to increase or decrease electric rates periodically with WUTC approval to reflect changes in power supply costs. The ERM provides for Avista Utilities to incur the cost of, or receive the benefit from, the first $9.0 million in annual power supply costs above or below the amount included in base retail rates, which is referred to as the dead band. Under the ERM, 90 percent of the power supply costs exceeding or below the $9.0 million dead band are deferred for future surcharge or rebate to Avista Utilities' customers. The remaining 10 percent of power supply costs are an expense of, or benefit to, the Company. In its March 2005 general rate case filing, Avista Utilities has requested that the $9.0 million dead band be eliminated and that 90 percent of all power supply costs above or below the amount included in base retail rates be deferred.

Avista Utilities received the benefit of $0.7 million of the initial $9.0 million of power supply costs below the amount included in base retail rates during the six months ended June 30, 2005; however, Avista Utilities expects to expense the full $9.0 million above the amount included in base retail rates during 2005. This will result in an expense of $9.7 million for the second half of 2005 that includes the reversal of the $0.7 million benefit received in the first half of 2005. The Company expensed the initial $9.0 million of power supply costs above the amount

included in base retail rates during 2004, 2003 and 2002 ($4.5 million in 2002 due to mid-year implementation on July 1, 2002).

Under the ERM, Avista Utilities agreed to 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. Avista Utilities made its annual filing with the WUTC on March 30, 2005 related to $10.8 million of deferred power costs incurred for 2004. On June 29, 2005, the WUTC issued an order, which approved the recovery of the $10.8 million of deferred power costs incurred for 2004. In addition, on or before December 31, 2006, Avista Utilities will make a filing with the WUTC that will allow interested parties the opportunity to review and propose changes to the ERM.

Avista Utilities has a PCA mechanism in Idaho that allows it to modify electric rates periodically with IPUC approval. Under the PCA mechanism, Avista Utilities defers 90 percent of the difference between certain actual net power supply expenses and the authorized level of net power supply expense approved in the last Idaho general rate case. As disclosed at “General Rate Cases” above, in October 2004, the IPUC issued its final order with respect to general electric and natural gas rate cases filed by Avista Utilities in Idaho. The IPUC authorized the recovery of remaining deferred power costs over a two-year period through a PCA rate surcharge to customers that was reduced to 4.4 percent. The PCA surcharge was further reduced to 2.5 percent in April 2005 with the approval of the inclusion of the remaining interest in Coyote Springs 2 in base electric rates. The decrease in the PCA rate surcharge extends the recovery period of deferred power costs by an additional year.

The following table shows activity in deferred power costs for Washington and Idaho during 2004 and the six months ended June 30, 2005 (dollars in thousands):

	Washington	Idaho	Total
Deferred power costs as of December 31, 2003	$ 125,705	$ 30,285	$155,990
Activity from January 1 – December 31, 2004:			
Power costs deferred	10,498	15,276	25,774
Unrealized gain on fuel contracts (1)	(3,139)	(1,596)	(4,735)
Interest and other net additions	6,354	532	6,886
Write-off of deferred power costs	—	(11,959)	(11,959)
Recovery of deferred power costs through retail rates	(26,210)	(23,040)	(49,250)
Deferred power costs as of December 31, 2004	113,208	9,498	122,706
Activity from January 1 – June 30, 2005:			
Power costs deferred	—	(236)	(236)
Interest and other net additions	2,851	158	3,009
Recovery of deferred power costs through retail rates	(13,499)	(3,485)	(16,984)
Deferred power costs as of June 30, 2005	$ 102,560	$ 5,935	$108,495

(1) Unrealized gains and losses on fuel contracts are not included in the ERM and PCA mechanism until the contracts are settled or realized.

Purchased Gas Adjustments

Natural gas commodity costs in excess of, or which fall below, the amount recovered in current retail rates are deferred and recovered or refunded as a pass-through to customers in future periods with applicable regulatory approval through adjustments to rates. Currently, purchased gas adjustments provide for the deferral and future recovery or refund of 100 percent of the difference between commodity costs and the amount recovered in current retail rates in Washington, Idaho and Oregon. On August 2, 2005, Avista Utilities filed a tariff revision in Oregon that, if approved, would provide for 100 percent recovery of known hedges. With respect to the unhedged portion of customer loads, the tariff provision would provide for the deferral and future recovery or refund of 90 percent of the difference between actual prices and the amount recovered in current retail rates effective October 1, 2005. The Company has hedged most of its natural gas load requirements in Oregon. During September through November of 2004, natural gas rate increases of 11.7 percent, 14.2 percent and 12.6 percent were approved and implemented in Washington, Idaho and Oregon, respectively. These natural gas rate increases are designed to pass through changes in purchased natural gas costs to customers with no change in Avista Utilities’ gross margin or net income. Total deferred natural gas costs were $26.4 million and $28.6 million as of June 30, 2005 and December 31, 2004, respectively.

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Natural Gas Benchmark Mechanism

See "Natural Gas Benchmark Mechanism" in "Note 1 of the Notes to Consolidated Financial Statements" for a description of the Natural Gas Benchmark Mechanism and related Agency Agreement. Effective April 1, 2005, the Natural Gas Benchmark Mechanism and related Agency Agreement were terminated and the management of natural gas procurement functions was moved from Avista Energy back to Avista Utilities. This was required for Washington customers by WUTC orders issued over one year earlier, in February 2004, and Avista Utilities' resulting transition plan approved by the WUTC in April 2004. The Company also elected to move these functions back to Avista Utilities for Idaho and Oregon natural gas customers.

Power Market Issues

Legal and Regulatory Proceedings in Western Power Markets

Avista Energy and Avista Utilities 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 and hearings in California and the Pacific Northwest, market conduct investigations by the FERC (including a specific investigation of Avista Utilities and Avista Energy), and complaints and cross-complaints filed by various parties with respect 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 Avista Energy and Avista Utilities, which could result in a negative impact on future earnings. Avista Energy and Avista Utilities have joined other parties in opposing these refund claims and complaints for damages. See further information in "Note 11 of the Notes to Consolidated Financial Statements."

Market Conduct Investigations and Market-Based Rate Authority

As a result of certain revelations about alleged improper practices engaged in by Enron and certain of its affiliates, the FERC initiated investigations in February 2002 of Avista Corp. doing business as Avista Utilities, Avista Energy and other unrelated parties. Avista Utilities and Avista Energy cooperated with the FERC investigation by providing requested documents and other information. Several parties filed documents with the FERC in March 2003 alleging improper market conduct by various parties, including Avista Utilities and Avista Energy, and requesting refunds and other relief. Avista Utilities and Avista Energy filed replies in response to the allegations of the parties.

In March 2003, the FERC policy staff issued its final report on its investigation of western energy markets. In the report, the FERC policy staff recommended the issuance of "show cause" orders to dozens of companies to respond to allegations of possible misconduct in the western energy markets during 2000 and 2001. Of the companies named in the March 2003 FERC policy staff report, Avista Corp. and Avista Energy were among the few that had already been subjects of a FERC investigation. In April 2004, the FERC approved an agreement that resolves the investigation of Avista Corp. and Avista Energy. Other parties filed requests for rehearing and filed motions to intervene in these proceedings. In April 2005, the FERC denied the requests for rehearing and motion to intervene in these proceedings; however, the other parties subsequently filed appeals with the United States Court of Appeals for the Ninth Circuit in response to the FERC's denial of rehearing requests. See further information under "Federal Energy Regulatory Commission Inquiry" in "Note 11 of the Notes to Consolidated Financial Statements."

Every three years or more frequently if certain regulatory triggers are met, Avista Corp. doing business as Avista Utilities, and Avista Energy are required to file for renewal of their respective market-based rate authority with the FERC. Avista Utilities and Avista Energy made their respective filings with the FERC in September 2004. By orders issued in March 2005, the FERC approved the renewal of the market-based rate authority of Avista Utilities and Avista Energy.

Wholesale Energy Markets and Development of Regional Transmission Organizations

In July 2005, the FERC announced that it had officially abandoned its efforts commenced in 2002 to create revised wholesale power market rules. However, the FERC continues its efforts with respect to the formation of Regional Transmission Organizations. This could significantly change how transmission facilities are regulated and operated.

Avista Corp. has participated with other utilities in the western United States on the possible formation of a Regional Transmission Organization (RTO). Interim bylaws governing continuing developmental activities for this non-profit corporation, under the name Grid West, were adopted in December 2004. The next phase of the development of Grid West would be the establishment of a board of directors, which is currently planned for late 2005. Avista Corp. is also participating in concurrent discussions with the Transmission Improvements Group regarding the

enhancement of existing organizational structures to incorporate certain elements and functions that have been contemplated to be included in a RTO.

The final proposal for any RTO must be filed with the FERC and approved by the boards of directors of the filing companies and regulators in various states. The Company's decision to move forward with the formation of any RTO serving the Pacific Northwest region, as well as the legal, financial and operating implications of such decisions, will ultimately depend on the terms and conditions related to the formation of the entities and conditions established in the regulatory approval processes. The Company cannot predict these implications.

Results of Operations

Contribution to Diluted Earnings per Common Share by Business Segments

The following table presents the contribution to diluted earnings per common share by business segments for the three and six months ended June 30:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Avista Utilities	$ 0.38	$ 0.19	$ 0.76	$ 0.41
Energy Marketing and Resource Management	(0.01)	0.03	(0.18)	0.10
Avista Advantage	0.02	(0.01)	0.04	(0.01)
Other	(0.01)	—	(0.03)	(0.03)
Earnings per common share before cumulative effect of accounting change	0.38	0.21	0.59	0.47
Loss per common share from cumulative effect of accounting change	—	—	—	(0.01)
Total earnings per common share, diluted	$ 0.38	$ 0.21	$ 0.59	$ 0.46

Overall Operations

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

Net income was $18.6 million for the three months ended June 30, 2005 compared to $10.1 million for the three months ended June 30, 2004. This increase was primarily due to the improved performance of Avista Utilities, as well as Avista Advantage. This was partially offset by a net loss for the Energy Marketing and Resource Management segment and the Other business segment.

Energy Marketing and Resource Management incurred a net loss of $0.3 million for the three months ended June 30, 2005 compared to net income of $1.5 million for the three months ended June 30, 2004. The net loss was primarily due to a net loss incurred at Avista Power related to planned maintenance at the Lancaster Project. Avista Energy incurred a net loss of less than $0.1 million for the second quarter of 2005.

Net income for Avista Utilities was $18.4 million for the three months ended June 30, 2005, compared to $9.1 million for the three months ended June 30, 2004. The increase reflects the positive effects of general rate increases implemented during the second half of 2004 in Washington and Idaho, the benefit of lower electric resource costs in 2005 under the Washington ERM dead band as compared to the expense of higher electric resource costs in 2004, as well as the $3.2 million pre-tax gain on the sale of Avista Utilities' South Lake Tahoe natural gas distribution properties.

Net income for Avista Advantage was $0.9 million for the three months ended June 30, 2005 compared to a net loss of $0.4 million for the three months ended June 30, 2004. The change was primarily due to an increase in operating revenues from customer growth, as well as the settlement of an employment contract during the three months ended June 30, 2004.

The Other business segment incurred a net loss of $0.5 million for the three months ended June 30, 2005 compared to a net loss of $0.1 million for the three months ended June 30, 2004. The increase in the net loss was primarily due to the gain on the sale of non-operating assets during the three months ended June 30, 2004.

Total revenues increased $46.9 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004. Avista Utilities' revenues increased $38.2 million due to increases in both electric and natural gas revenues. The increase in natural gas revenues was primarily due to increased natural gas wholesale sales and

natural gas rate increases implemented during 2004, partially offset by the sale of the South Lake Tahoe properties. The increase in electric revenues primarily reflects an increase in wholesale revenues and a slight increase in retail revenues. Revenues from Energy Marketing and Resource Management decreased $21.0 million primarily due to decreased revenues under the Agency Agreement with Avista Utilities as natural gas procurement operations were transitioned to Avista Utilities effective April 1, 2005, partially offset by increased revenues for Avista Energy Canada. Revenues from Avista Advantage increased $2.2 million to $7.7 million primarily as a result of customer growth.

Total resource costs increased $35.5 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004. Resource costs for Avista Utilities increased $25.6 million primarily due to an increase in purchased natural gas costs, as well as increased net amortization of deferred power costs. The increase in purchased natural gas costs was primarily due to an increase in prices. The increase in the net amortization of deferred power costs reflects lower electric resource costs as compared to the amount included in base retail rates and as such lower power cost deferrals. Avista Utilities' resource costs reflect a positive benefit of $0.9 million of the $9.0 million dead band under the ERM in Washington for the second quarter of 2005, compared to expensing $2.7 million in the second quarter of 2004. This was due to lower actual electric resource costs, relative to the amount allowed in base retail rates, in 2005 as compared to higher electric resource costs in 2004. Resource costs for Energy Marketing and Resource Management decreased $17.6 million primarily due to decreased resource costs under the Agency Agreement with Avista Utilities as natural gas procurement operations were transitioned to Avista Utilities effective April 1, 2005, partially offset by increased resource costs for Avista Energy Canada.

Intersegment eliminations, which decrease both operating revenues and resource costs, were $27.5 million for the three months ended June 30, 2004. There were not any intersegment eliminations for operating revenues and resource costs for the three months ended June 30, 2005 as the Agency Agreement between Avista Utilities and Avista Energy was terminated effective April 1, 2005.

Administrative and general expenses increased $0.3 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004 primarily due to increased expenses for Avista Utilities, partially offset by decreased expenses for Energy Marketing and Resource Management and Avista Advantage. The increase for Avista Utilities was primarily due to an increase in incentive compensation. The decrease for Energy Marketing and Resource Management was primarily a result of decreased compensation expense. The decrease for Avista Advantage was due to the settlement of an employment contract during the three months ended June 30, 2004.

Depreciation and amortization increased $0.8 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004 due in part to utility plant additions at Avista Utilities and the resulting increase in depreciation expense.

Interest expense decreased $0.7 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004 primarily due to a decrease in the effective borrowing rate as a result of previous debt issuances and repurchases.

Other income-net decreased $0.9 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004 primarily due to decreased losses on certain investments during 2005 compared to gains in the prior period, as well as gains on the disposition of non-operating assets during the three months ended June 30, 2004. This was partially offset by an increase in interest income.

Income taxes increased $3.9 million for the three months ended June 30, 2005 compared to the three months ended June 30, 2004, primarily due to increased income before income taxes. The effective tax rate was 34.8 percent for the three months ended June 30, 2005 compared to 37.2 percent for the three months ended June 30, 2004. The decrease in the effective tax rate was partially due to tax credits for the Kettle Falls Plant that the Company began receiving the benefit from in 2005.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

Net income was $28.8 million for the six months ended June 30, 2005 compared to $22.4 million for the six months ended June 30, 2004. This increase was primarily due to the improved performance of Avista Utilities, as well as Avista Advantage. This was partially offset by a net loss for Avista Energy (Energy Marketing and Resource Management segment).

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Energy Marketing and Resource Management incurred a net loss of $8.6 million for the six months ended June 30, 2005 compared to net income of $5.0 million for the six months ended June 30, 2004. The net loss for the six months ended June 30, 2005 was primarily due to losses in Avista Energy's natural gas portfolio during the first quarter of 2005.

Net income for Avista Utilities was $37.4 million for the six months ended June 30, 2005, compared to $19.9 million for the six months ended June 30, 2004. The increase for Avista Utilities was primarily due to an increase in gross margin as a result of general rate increases and the benefit of lower electric resource costs in 2005 under the Washington ERM dead band as compared to the expense of higher electric resource costs in 2004, as well as the $3.2 million pre-tax gain from the sale of the South Lake Tahoe natural gas distribution properties in April 2005. This was partially offset by warmer weather in the Washington and Idaho service territories during the first quarter, which decreased use per customer.

Net income for Avista Advantage was $1.7 million for the six months ended June 30, 2005 compared to a net loss of $0.4 million for the six months ended June 30, 2004. The change was primarily due to an increase in operating revenues from customer growth, as well as the settlement of an employment contract during the six months ended June 30, 2004.

The Other business segment incurred a net loss of $1.7 million for the six months ended June 30, 2005 compared to a net loss of $1.8 million (excluding the cumulative effect of accounting change) for the six months ended June 30, 2004.

Total revenues increased $65.9 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004. Avista Utilities' revenues increased $67.9 million due to increases in both electric and natural gas revenues. The increase in natural gas revenues was primarily due to increased natural gas wholesale sales and natural gas rate increases implemented during 2004. The increase in electric revenues primarily reflects an increase in wholesale revenues and a slight increase in retail revenues, partially offset by a decrease in sales of fuel. Revenues from Energy Marketing and Resource Management decreased $73.5 million primarily due to decreased revenues under the Agency Agreement with Avista Utilities as natural gas procurement operations were transitioned to Avista Utilities effective April 1, 2005, and decreased net trading margin on contracts accounted for under SFAS No. 133, partially offset by increased revenues for Avista Energy Canada. Revenues from Avista Advantage increased $4.2 million to $14.9 million primarily as a result of customer growth.

Total resource costs increased $54.4 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004. Resource costs for Avista Utilities increased $38.7 million primarily due to an increase in purchased natural gas costs, as well as net amortization of deferred natural gas costs for the six months ended June 30, 2005 compared to net deferrals for the six months ended June 30, 2004. The increase in purchased natural gas costs was primarily due to an increase in prices. Avista Utilities' resource costs reflect a positive benefit of $0.7 million of the $9.0 million dead band under the ERM in Washington for the first half of 2005, compared to expensing the entire $9.0 million in the first half of 2004. This was due to lower actual electric resource costs, relative to the amount allowed in base retail rates, in 2005 as compared to higher electric resource costs in 2004. Resource costs for Energy Marketing and Resource Management decreased $51.6 million primarily due to decreased resource costs under the Agency Agreement with Avista Utilities as natural gas procurement operations were transitioned to Avista Utilities effective April 1, 2005, partially offset by increased resource costs for Avista Energy Canada.

Intersegment eliminations, which decrease both operating revenues and resource costs, were $19.4 million for the six months ended June 30, 2005 compared to $86.7 million for the six months ended June 30, 2004, representing decreased purchases of natural gas as the Agency Agreement between Avista Utilities and Avista Energy was terminated effective April 1, 2005.

Operations and maintenance expenses increased $1.0 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004 primarily due to increased costs for Avista Advantage. The increased costs for Avista Advantage primarily reflects increased labor costs necessary to service an expanding customer base.

Administrative and general expenses decreased $0.9 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004 primarily due to decreased expenses for Energy Marketing and Resource Management, Avista Advantage and the Other business segment, partially offset by an increase for Avista Utilities. The decrease for Energy Marketing and Resource Management was primarily a result of decreased compensation expense. The decrease for Avista Advantage was due to the settlement of an employment contract during the six

months ended June 30, 2004. The decrease for the Other business segment was due to the accrual of an environmental liability during the six months ended June 30, 2004. The increase for Avista Utilities was primarily due to an increase in incentive compensation.

Depreciation and amortization increased $5.8 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004 due in part to utility plant additions at Avista Utilities and the resulting increase in depreciation expense. This was also due to a correction at Avista Utilities for overstated depreciation expense in prior periods recorded during the first quarter of 2004.

Interest expense decreased $1.1 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004 primarily due to a decrease in the effective borrowing rate as a result of previous debt issuances and repurchases.

Other income-net decreased $0.7 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004 primarily due to decreased interest income and increased losses on certain investments, as well as gains on the disposition of non-operating assets during the six months ended June 30, 2004.

Income taxes increased $1.6 million for the six months ended June 30, 2005 compared to the six months ended June 30, 2004, primarily due to increased income before income taxes. The effective tax rate was 36.8 percent for the six months ended June 30, 2005 compared to 39.9 percent for the six months ended June 30, 2004. The decrease in the effective tax rate was partially due to tax credits for the Kettle Falls Plant that the Company began receiving the benefit from in 2005.

During the six months ended June 30, 2004, the Other business segment recorded as a cumulative effect of accounting change a charge of $0.5 million related to the implementation of FIN 46, which required Avista Ventures to consolidate several minor entities.

Avista Utilities

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

Net income for Avista Utilities was $18.4 million for the three months ended June 30, 2005 compared to $9.1 million for the three months ended June 30, 2004. Avista Utilities' income from operations was $48.9 million for the three months ended June 30, 2005 compared to $35.7 million for the three months ended June 30, 2004. This increase was primarily a result of increased gross margin (operating revenues less resource costs) due to general rate increases and the benefit of lower electric resource costs in 2005 under the Washington ERM dead band as compared to the expense of higher electric resource costs in 2004, as well as the $3.2 million pre-tax gain related to the sale of the South Lake Tahoe natural gas distribution properties.

The following table presents Avista Utilities' gross margin for the three months ended June 30 (dollars in thousands):

	Electric		Natural Gas		Total	
	2005	2004	2005	2004	2005	2004
Operating revenues	$ 168,746	$ 151,549	$ 69,573	$ 48,598	$ 238,319	$ 200,147
Resource costs	63,034	56,533	49,688	30,591	112,722	87,124
Gross margin	$ 105,712	$ 95,016	$ 19,885	$ 18,007	$ 125,597	$ 113,023

Avista Utilities' operating revenues increased $38.2 million and resource costs increased $25.6 million, which resulted in an increase of $12.6 million in gross margin for the three months ended June 30, 2005 as compared to the three months ended June 30, 2004. The gross margin on electric sales increased $10.7 million and the gross margin on natural gas sales increased $1.9 million. The increase in electric gross margin was partially due to the Idaho electric general rate increase implemented in September 2004, as well as customer growth. The increase in electric gross margin was also due to a decrease in electric resource costs as compared to the amount included in base retail rates and the benefit of $0.9 million of power supply costs in Washington below the amount included in base retail rates during the second quarter of 2005, compared to the expense of $2.7 million of power supply costs exceeding the amount included in base retail rates for the second quarter of 2004. This was primarily a result of improved hydroelectric generation from earlier-than-normal runoff due to warmer weather in the first quarter and increased precipitation during the second quarter of 2005. In addition, total retail loads were less than expected and Avista Utilities optimized its available resources through increased sales in the wholesale market. The increase in the gross margin on natural gas sales was primarily due to the Idaho natural gas general rate increase implemented in

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September 2004 and the Washington natural gas general rate increase implemented in November 2004, as well as customer growth in Washington, Idaho and Oregon. The effects of general rate increases and customer growth were partially offset by the sale of the South Lake Tahoe properties in April 2005.

The following table presents Avista Utilities' electric operating revenues and megawatt-hour (MWh) sales for the three months ended June 30 (dollars and MWhs in thousands):

	Electric Operating Revenues		Electric Energy MWh sales	
	2005	2004	2005	2004
Residential	$ 42,084	$ 41,718	681	659
Commercial	48,826	48,703	715	689
Industrial	23,221	23,128	528	527
Public street and highway lighting	1,241	1,202	6	6
Total retail	115,372	114,751	1,930	1,881
Wholesale	32,743	15,388	864	533
Sales of fuel	16,606	16,328	—	—
Other	4,025	5,082	—	—
Total	$ 168,746	$ 151,549	2,794	2,414

Retail electric revenues increased $0.6 million for the three months ended June 30, 2005 from the three months ended June 30, 2004. This increase was primarily due to an increase in total MWhs sold (increased revenues $2.9 million), partially offset by a decrease in revenue per MWh (decreased revenues $2.3 million). The increase in total MWhs sold was primarily due to customer growth and partially due to colder weather. Total heating degree days at Spokane, Washington for the three months ended June 30, 2005 increased as compared to the three months ended June 30, 2004 with both periods warmer than normal. As such, electric loads and revenues were positively affected by weather when comparing 2005 and 2004 results. In September 2004, a general electric rate increase was implemented in Idaho. However, this was almost entirely offset by a decrease in the PCA surcharge, such that the net increase in rates to Idaho customers was only 1.9 percent. Although the general rate case increased gross margin, income from operations and net income, it did not have a significant effect on operating revenues for the three months ended June 30, 2005 as compared to the three months ended June 30, 2004.

Wholesale electric revenues increased $17.4 million primarily due to an increase in wholesale sales volumes and partially due to an increase in wholesale sales prices. The increase in wholesale sales volumes reflects added generation capacity, increased runoff to hydroelectric generating assets and lower than anticipated retail loads, which resulted in excess resources that were sold in the wholesale market.

Other electric revenues decreased $1.1 million primarily as a result of decreased transmission revenues.

The following table presents Avista Utilities' natural gas operating revenues and therms delivered for the three months ended June 30 (dollars and therms in thousands):

	Natural Gas Operating Revenues		Natural Gas Therms Delivered	
	2005	2004	2005	2004
Residential	$ 33,381	$ 28,758	29,035	29,205
Commercial	17,397	14,901	17,710	17,630
Industrial	1,896	1,772	2,341	2,634
Total retail	52,674	45,431	49,086	49,469
Wholesale	13,676	18	22,687	35
Transportation	2,222	2,289	38,374	36,152
Other	1,001	860	97	420
Total	$ 69,573	$ 48,598	110,244	86,076

Natural gas revenues increased $21.0 million for the three months ended June 30, 2005 from the three months ended June 30, 2004 due to an increase in both wholesale and retail natural gas revenues. The increase in wholesale revenues reflects sales of excess resources acquired as part of the natural gas procurement process that was implemented at Avista Utilities effective April 1, 2005 with the termination of the Agency Agreement with Avista Energy. The $7.2 million increase in retail natural gas revenues was primarily due to an increase in retail rates (increased revenues $7.6 million), partially offset by a decrease in volumes (decreased revenues $0.4 million). During September through November of 2004, retail rates for natural gas were increased in response to an increase in current and projected natural gas costs. In September 2004, a general natural gas rate increase was implemented

in Idaho. In November 2004, a general natural gas rate increase was implemented in Washington. The decrease in total therms sold was primarily due to the sale of the South Lake Tahoe operations, partially offset by customer growth and colder weather in the Washington, Idaho and Oregon service territories.

The following table presents Avista Utilities' average number of electric and natural gas customers for the three months ended June 30:

	Electric Customers		Natural Gas Customers	
	2005	2004	2005	2004
Residential	292,638	286,977	264,174	267,333
Commercial	37,150	36,605	31,587	31,861
Industrial	1,412	1,411	306	310
Public street and highway lighting	418	419	—	—
Total retail	331,618	325,412	296,067	299,504
Wholesale	45	40	14	1
Transportation	—	—	99	89
Total customers	331,663	325,452	296,180	299,594

The following table presents Avista Utilities' heating degree days for the three months ended June 30:

	2005	2004
Heating degree days (1):		
Spokane, Washington actual	929	900
Spokane, Washington 30 year average (2)	1,044	1,044
Percentage of average	89%	86%
Medford, Oregon actual	644	489
Medford, Oregon 30 year average (2)	704	704
Percentage of average	91%	69%

(1) Heating degree days are the measure of the coldness of weather experienced, based on the extent to which the average of the high and low temperatures for a day falls below 65 degrees Fahrenheit (degree days below historic indicate warmer than average temperatures).

(2) Computed for the period from 1971 through 2000.

The following table presents Avista Utilities' resource costs for the three months ended June 30 (dollars in thousands):

	2005	2004
Electric resource costs:		
Power purchased	$ 25,228	$24,767
Power cost amortizations, net of deferrals	7,726	1,674
Fuel for generation	13,004	4,569
Other fuel costs	16,393	20,680
Other regulatory amortizations, net	(1,434)	21
Other electric resource costs	2,117	4,822
Total electric resource costs	63,034	56,533
Natural gas resource costs:		
Natural gas purchased	53,516	32,467
Natural gas deferrals, net of amortization	(4,370)	(2,586)
Other regulatory amortizations, net	542	710
Total natural gas resource costs	49,688	30,591
Total resource costs	$112,722	$87,124

Power purchased for the three months ended June 30, 2005 increased $0.5 million compared to the three months ended June 30, 2004 due to an increase in the volume of power purchases (increased costs $0.8 million), partially offset by a decrease in the price of power purchases (decreased costs $0.3 million).

Net amortization of deferred power costs was $7.7 million for the three months ended June 30, 2005 compared to $1.7 million for the three months ended June 30, 2004. During the three months ended June 30, 2005, Avista Utilities recovered (collected as revenue) $5.9 million of previously deferred power costs in Washington and $1.3

million in Idaho. There was a decrease in the recovery of previously deferred power costs in Idaho as compared to the three months ended June 30, 2004, which was primarily due to the reduction of the PCA rate surcharge in the Idaho general rate case. During the three months ended June 30, 2005, Avista Utilities deferred $0.5 million of power costs below the amount included in base retail rates in Idaho. Avista Utilities did not defer any power costs in Washington during the three months ended June 30, 2005 as power costs were below the amount included in base retail rates and within the $9.0 million threshold.

Fuel for generation for the three months ended June 30, 2005 increased $8.4 million compared to the three months ended June 30, 2004 due to an increase in fuel prices and greater use of thermal generation, including the addition of the remaining interest in Coyote Springs 2.

Other fuel costs for the three months ended June 30, 2005 decreased $4.3 million compared to the three months ended June 30, 2004. This natural gas fuel was sold with the associated revenues reflected as sales of fuel. Revenues from selling the natural gas exceeded other fuel costs. This excess revenue is accounted for under the ERM in Washington and the PCA in Idaho. The decrease in other fuel costs was primarily due to a greater percentage of fuel used in generation.

The expense for natural gas purchased for the three months ended June 30, 2005 increased $21.0 million compared to the three months ended June 30, 2004 due to an increase in the cost of natural gas (increased costs $4.9 million) and an increase in total therms purchased (increased costs $16.1 million). The increase in total therms purchased is consistent with an increase in wholesale sales. During the three months ended June 30, 2005, Avista Utilities had $4.4 million of net deferrals of natural gas costs compared to $2.6 million of net deferrals for the three months ended June 30, 2004, reflecting higher natural gas prices.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

Net income for Avista Utilities was $37.4 million for the six months ended June 30, 2005 compared to $19.9 million for the six months ended June 30, 2004. Avista Utilities' income from operations was $100.5 million for the six months ended June 30, 2005 compared to $75.4 million for the six months ended June 30, 2004. This increase was primarily a result of increased gross margin (operating revenues less resource costs) due to general rate increases, the benefit of lower electric resource costs in 2005 under the Washington ERM dead band as compared to the expense of higher electric resource costs in 2004 and customer growth, as well as the $3.2 million pre-tax gain related to the sale of Avista Utilities' South Lake Tahoe natural gas distribution properties. This was partially offset by decreased use per customer in the Washington and Idaho service territories due to warmer weather during the first quarter of 2005 as compared to the first quarter of 2004, as well as an increase in depreciation expense.

The following table presents Avista Utilities' gross margin for the six months ended June 30 (dollars in thousands):

	Electric		Natural Gas		Total	
	2005	2004	2005	2004	2005	2004
Operating revenues	$ 345,792	$ 323,515	$ 212,243	$ 166,636	$ 558,035	$ 490,151
Resource costs	142,951	142,197	151,484	113,571	294,435	255,768
Gross margin	$ 202,841	$ 181,318	$ 60,759	$ 53,065	$ 263,600	$ 234,383

Avista Utilities' operating revenues increased $67.9 million and resource costs increased $38.7 million, which resulted in an increase of $29.2 million in gross margin for the six months ended June 30, 2005 as compared to the six months ended June 30, 2004. The gross margin on electric sales increased $21.5 million and the gross margin on natural gas sales increased $7.7 million. The increase in electric gross margin was partially due to a decrease in electric resource costs as compared to the amount included in base retail rates and the benefit of $0.7 million of power supply costs in Washington below the amount included in base retail rates during the first half of 2005, compared to the expense of $9.0 million of power supply costs exceeding the amount included in base retail rates for the first half of 2004. This was primarily a result of improved hydroelectric generation from earlier-than-normal runoff due to warmer weather in the first quarter and increased precipitation during the second quarter of 2005. In addition, total retail loads were less than expected and Avista Utilities optimized its available resources through increased sales in the wholesale market. The increase in electric gross margin was also due to the Idaho electric general rate increase implemented in September 2004 as well as customer growth, partially offset by warmer weather during the first quarter of 2005 as compared to the first quarter of 2004. The increase in the gross margin on natural gas sales was primarily due to the Idaho natural gas general rate increase implemented in September 2004 and the Washington natural gas general rate increase implemented in November 2004, colder weather in the Oregon service territory, as well as customer growth. The effects of general rate increases and customer growth were partially offset

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by warmer weather in the Washington and Idaho service territories during the first quarter of 2005 and the sale of the South Lake Tahoe distribution properties in April 2005.

The following table presents Avista Utilities' electric operating revenues and megawatt-hour (MWh) sales for the six months ended June 30 (dollars and MWhs in thousands):

	Electric Operating Revenues		Electric Energy MWh sales	
	2005	2004	2005	2004
Residential	$ 104,834	$ 104,450	1,690	1,653
Commercial	98,798	98,412	1,448	1,405
Industrial	45,117	44,345	1,029	1,025
Public street and highway lighting	2,470	2,406	13	13
Total retail	251,219	249,613	4,180	4,096
Wholesale	60,477	25,502	1,362	753
Sales of fuel	26,253	39,357	—	—
Other	7,843	9,043	—	—
Total	$ 345,792	$ 323,515	5,542	4,849

Retail electric revenues increased $1.6 million for the six months ended June 30, 2005 from the six months ended June 30, 2004. This increase was primarily due to an increase in total MWhs sold (increased revenues $5.0 million), partially offset by a decrease in revenue per MWh (decreased revenues $3.4 million). The increase in total MWhs sold was primarily due to customer growth, partially offset by warmer weather. Total heating degree days at Spokane, Washington for the six months ended June 30, 2005 decreased as compared to the six months ended June 30, 2004 with both periods warmer than normal. As such, electric loads and revenues were negatively affected by weather when comparing 2005 and 2004 results. In September 2004, a general electric rate increase was implemented in Idaho. However, this was almost entirely offset by a decrease in the PCA surcharge, such that the net increase in rates to Idaho customers was only 1.9 percent. Although the general rate case increased gross margin, income from operations and net income, it did not have a significant effect on operating revenues for the six months ended June 30, 2005 as compared to the six months ended June 30, 2004.

Wholesale electric revenues increased $35.0 million primarily due to an increase in wholesale sales volumes and partially due to an increase in wholesale sales prices. The increase in wholesale sales volumes reflects added generation capacity, earlier-than-normal runoff to hydroelectric generating assets and lower than anticipated retail loads, which resulted in excess resources that were sold in the wholesale market.

Sales of fuel decreased $13.1 million as a greater percentage of fuel purchases were used in generation. Sales of fuel represents natural gas that was not used for generation when electric wholesale market prices were generally below the cost of operating the natural gas-fired thermal generating units.

The following table presents Avista Utilities' natural gas operating revenues and therms delivered for the six months ended June 30 (dollars and therms in thousands):

	Natural Gas Operating Revenues		Natural Gas Therms Delivered	
	2005	2004	2005	2004
Residential	$ 122,155	$ 102,666	113,441	113,239
Commercial	64,498	53,800	67,068	66,562
Industrial	5,215	4,083	6,428	6,113
Total retail	191,868	160,549	186,937	185,914
Wholesale	13,790	116	22,898	245
Transportation	4,433	4,288	83,173	77,368
Other	2,152	1,683	329	843
Total	$ 212,243	$ 166,636	293,337	264,370

Natural gas revenues increased $45.6 million for the six months ended June 30, 2005 from the six months ended June 30, 2004 primarily due to an increase in retail natural gas revenues and partially due to an increase in wholesale natural gas revenues. The increase in wholesale revenues reflects sales of excess resources acquired as part of the natural gas procurement process that was implemented at Avista Utilities effective April 1, 2005. The $31.3 million increase in retail natural gas revenues was primarily due to an increase in retail rates (increased revenues $30.3 million) and partially due to an increase in volumes (increased revenues $1.0 million). During September through

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November of 2004, retail rates for natural gas were increased in response to an increase in current and projected natural gas costs. In September and November 2004, general natural gas rate increases were implemented in Idaho and Washington, respectively. The increase in total therms sold was primarily due to customer growth and colder weather in the Oregon service territory, partially offset by warmer weather in the Washington and Idaho service territories and the sale of the South Lake Tahoe properties.

The following table presents Avista Utilities' average number of electric and natural gas customers for the six months ended June 30:

	Electric Customers		Natural Gas Customers	
	2005	2004	2005	2004
Residential	292,774	287,259	269,958	267,490
Commercial	37,178	36,586	32,073	31,855
Industrial	1,411	1,412	307	310
Public street and highway lighting	416	422	—	—
Total retail	331,779	325,679	302,338	299,655
Wholesale	44	39	7	1
Transportation	—	—	91	83
Total customers	331,823	325,718	302,436	299,739

The following table presents Avista Utilities' heating degree days for the six months ended June 30:

	2005	2004
Heating degree days (1):		
Spokane, Washington actual	3,610	3,703
Spokane, Washington 30 year average (2)	3,919	3,919
Percentage of average	92%	94%
Medford, Oregon actual	2,444	2,160
Medford, Oregon 30 year average (2)	2,668	2,668
Percentage of average	92%	81%

(1) Heating degree days are the measure of the coldness of weather experienced, based on the extent to which the average of the high and low temperatures for a day falls below 65 degrees Fahrenheit (degree days below historic indicate warmer than average temperatures).

(2) Computed for the period from 1971 through 2000.

The following table presents Avista Utilities' resource costs for the six months ended June 30 (dollars in thousands):

	2005	2004
Electric resource costs:		
Power purchased	$ 65,159	$ 66,954
Power cost amortizations, net of deferrals	17,221	12,081
Fuel for generation	35,459	11,527
Other fuel costs	24,978	44,995
Other regulatory amortizations, net	(3,863)	(619)
Other electric resource costs	3,997	7,259
Total electric resource costs	142,951	142,197
Natural gas resource costs:		
Natural gas purchased	147,589	118,887
Natural gas amortizations (deferrals), net	1,792	(7,798)
Other regulatory amortizations, net	2,103	2,482
Total natural gas resource costs	151,484	113,571
Total resource costs	$294,435	$255,768

Power purchased for the six months ended June 30, 2005 decreased $1.8 million compared to the six months ended June 30, 2004 due to a decrease in the volume of power purchases (decreased costs $2.6 million), partially offset by an increase in the price of power purchases (increased costs $0.8 million). The decrease in the volume of power purchases was primarily due to increased hydroelectric and thermal generation. As such, Avista Utilities purchased less power on the wholesale market to meet its load requirements.

Net amortization of deferred power costs was $17.2 million for the six months ended June 30, 2005 compared to $12.1 million for the six months ended June 30, 2004. During the six months ended June 30, 2005, Avista Utilities recovered (collected as revenue) $13.5 million of previously deferred power costs in Washington and $3.5 million in Idaho. There was a decrease in the recovery of previously deferred power costs in Idaho as compared to the six months ended June 30, 2004, which was primarily due to the reduction of the PCA rate surcharge in the Idaho general rate case. During the six months ended June 30, 2005, Avista Utilities deferred $0.2 million of power costs below the amount included in base retail rates in Idaho. Avista Utilities did not defer any power costs in Washington during the six months ended June 30, 2005 as power costs were below the amount included in base retail rates and within the $9.0 million threshold.

Fuel for generation for the six months ended June 30, 2005 increased $23.9 million compared to the six months ended June 30, 2004 due to an increase in fuel prices and greater use of thermal generation, including the addition of the remaining interest in Coyote Springs 2.

Other fuel costs for the six months ended June 30, 2005 decreased $20.0 million compared to the six months ended June 30, 2004. This natural gas fuel was sold with the associated revenues reflected as sales of fuel. Revenues from selling the natural gas exceeded other fuel costs. This excess revenue is accounted for under the ERM in Washington and the PCA in Idaho. The decrease in other fuel costs was primarily due to a greater percentage of fuel used in generation.

The expense for natural gas purchased for the six months ended June 30, 2005 increased $28.7 million compared to the six months ended June 30, 2004 due to an increase in the cost of natural gas (increased costs $13.7 million) and an increase in total therms purchased (increased costs $15.0 million). The increase in total therms purchased is consistent with an increase in wholesale sales. During the six months ended June 30, 2005, Avista Utilities had $1.8 million of net amortization of natural gas costs compared to $7.8 million of net deferrals for the six months ended June 30, 2004. The change reflects the net recovery of deferred natural gas costs from customers during the first half of 2005 compared to net deferrals during the first half of 2004.

Energy Marketing and Resource Management

Energy Marketing and Resource Management includes the results of Avista Energy and Avista Power.

Avista Energy's earnings are primarily derived from the following activities:

- Optimization of 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 within the WECC.
- Taking speculative positions on future price movements within established risk management policies.

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, as well as derivative commodity instruments not held for trading, are reported on a gross basis in operating revenues. Costs from contracts, which 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 Avista Energy's net realized gains and net unrealized gains (losses) for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net realized gains	$ 3,565	$ 17,206	$ 12,493	$ 20,554
Net unrealized gains (losses)	208	(10,002)	(17,304)	(3,444)
Total gross margin (operating revenues less resource costs)	$ 3,773	$ 7,204	$ (4,811)	$ 17,110

Energy Marketing and Resource Management's net loss was $0.3 million for the three months ended June 30, 2005, compared to net income of $1.5 million for the three months ended June 30, 2004. Energy Marketing and Resource Management's net loss was $8.6 million for the six months ended June 30, 2005, compared to net income of $5.0 million for the six months ended June 30, 2004.

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The net loss for the second quarter of 2005 was primarily due to a net loss incurred at Avista Power related to planned maintenance at the Lancaster Project. Avista Energy incurred a net loss of less than $0.1 million for the second quarter of 2005. The second quarter is historically a low earnings quarter for Avista Energy due to the difficulty in recovering demand charges that it pays for thermal generation it controls through a power purchase agreement related to the Lancaster Project. Because of the availability of relatively low cost hydroelectric generation during the period, sales of energy from thermal generation are generally lower this time of year than during other time periods. The net loss was decreased by the effects of differences between the economic management and the required accounting for certain energy contracts and physical assets under management as further discussed below.

The net loss for the six months ended June 30, 2005 was due to losses in Avista Energy's natural gas portfolio, primarily during the first quarter. The net loss was increased by the effects of differences between the economic management and the required accounting for certain energy contracts and physical assets under management as further discussed below.

Increases in natural gas prices had an overall negative effect on Avista Energy's results for the six months ended June 30, 2005. As markets moved counter to certain contracts, Avista Energy acted to adjust its position consistent with established risk management policies. This reduced the market risk; however, it had the effect of locking in losses on certain natural gas positions that were recorded during the first quarter.

Avista Energy continued to produce positive results on the power side of its business, which includes marketing and managing the output and availability of generation assets owned by other entities.

Analysis of differences in the economic management and the required accounting for certain contracts and physical assets under management

The operations of Avista Energy are managed on an economic basis reflecting all contracts and assets under management at estimated market value, which is different from the required accounting for certain contracts and physical assets under management. Under SFAS No. 133, certain contracts, which are considered derivatives and accounted for at market value, economically hedge other contracts and physical assets under management, which are not considered derivatives and not accounted for at market value. The accounting treatment does not impact the underlying cash flows or economics of these transactions. These differences are generally reversed in future periods as market values change or the contracts are settled or realized. These differences primarily relate to Avista Energy's management of natural gas inventory and resulting impact of the natural gas storage cycle, as well as Avista Energy's control of natural gas-fired generation through a power purchase agreement.

Avista Energy is affected by earnings volatility associated with the natural gas storage cycle, which runs annually from April through March of the next year. Generally, injections of natural gas into storage inventory take place in the summer months and natural gas is withdrawn from storage in the winter months. Avista Energy economically hedges the value of natural gas storage with financial and physical sales, effectively locking in a margin on storage. However, accounting rules require the natural gas storage to be carried at the lower of cost or market, while the forward sales contracts (which are derivatives) are marked-to-market using forward price curves. Changes in forward price curves result in income or losses on the derivative sales contracts, but do not affect the recorded values for natural gas inventory. Therefore, if Avista Energy enters into a forward contract to sell natural gas as a hedge against the value of natural gas in storage, and market prices subsequently increase, a loss is recorded in net income. While the market value of the natural gas inventory has also increased, the natural gas inventory remains valued at the lower of cost or market value. During the six months ended June 30, 2005, increases in the market price of natural gas and changes in inventory balances had a negative effect on net income of $3.7 million with respect to Avista Energy's economic management of natural gas inventory. During the six months ended June 30, 2004, this activity and changes in natural gas prices had a negative effect on net income of $0.8 million. During the second quarter of 2005, changes in the market price of natural gas and changes in inventory balances had a positive effect on net income of $0.3 million with respect to Avista Energy's economic management of natural gas inventory. During the second quarter of 2004, this activity and changes in natural gas prices had a negative effect on net income of $1.6 million. The difference should reverse when the transactions are settled or the natural gas has been withdrawn from storage. However, the difference could increase or decrease prior to the settlement of the transactions depending on the volatility of commodity prices. Based on natural gas prices, Avista Energy may elect not to withdraw its natural gas inventory until the first quarter of 2006 or later.

Avista Energy controls natural gas-fired generation through a power purchase agreement related to the Lancaster Project. The power purchase agreement gives Avista Energy the right to purchase natural gas for generation, and

convert to electricity for a fixed fee. Avista Energy has economically hedged the value of this power purchase agreement by entering into contracts to buy and sell natural gas and electricity during certain time periods in the future. Although the power purchase agreement is not a derivative and not marked-to-market, the contracts to buy and sell natural gas and electricity are derivatives that are recorded at estimated market value. Where possible, Avista Energy has designated the natural gas and electricity contracts as accounting hedges in accordance with SFAS No. 133 in order to reduce the earnings volatility associated with these combinations of accounting treatments. However, not all of these contracts qualify for hedge accounting. Avista Energy will continue to recognize changes in fair value of those contracts in earnings as unrealized gains and losses. In addition, the ineffective portion of the change in the forward value of qualifying hedges will continue to be recognized in earnings. Similar to natural gas inventory, the power purchase agreement is managed as if it is recorded at estimated market value. During the six months ended June 30, 2005, changes in natural gas and electricity prices for the future delivery periods in which the contract had been economically hedged (but not hedged in accordance with SFAS No. 133) had a positive effect on net income of approximately $0.1 million. During the six months ended June 30, 2004, this activity and changes in prices had a negative effect on net income of approximately $0.5 million. During the second quarter of 2005, changes in natural gas and electricity prices for the future delivery periods in which the contract had been economically hedged (but not hedged in accordance with SFAS No. 133) had a positive effect on net income of approximately $1.6 million. During the second quarter of 2004, this activity and changes in prices had a positive effect on net income of approximately $0.4 million.

Analysis of operating revenues, resource costs and gross margin for the three months ended June 30, 2005 compared to the three months ended June 30, 2004

Operating revenues decreased $21.0 million and resource costs decreased $17.6 million for the three months ended June 30, 2005 as compared to the three months ended June 30, 2004 resulting in a decrease in gross margin of $3.4 million. Avista Energy’s gross margin (operating revenues less resource costs) was a gain of $3.8 million for the three months ended June 30, 2005 compared to a gain of $7.2 million for the three months ended June 30, 2004. The decrease in gross margin was due to a decrease in both power and natural gas trading margins, partially offset by the positive effects of accounting for certain contracts and physical assets under management described above.

Net realized gains decreased to $3.6 million for the three months ended June 30, 2005 from $17.2 million for the three months ended June 30, 2004. Net realized gains represent the net gains on contracts that have settled. The decrease in net realized gains was primarily due to a decrease in the net gains on settled financial transactions and physical electric transactions. The total mark-to-market adjustment for Energy Marketing and Resource Management was a net unrealized gain of $0.2 million for the three months ended June 30, 2005 compared to a net unrealized loss of $10.0 million for the three months ended June 30, 2004.

Analysis of operating revenues, resource costs and gross margin for the six months ended June 30, 2005 compared to the six months ended June 30, 2004

Operating revenues decreased $73.5 million and resource costs decreased $51.6 million for the six months ended June 30, 2005 as compared to the six months ended June 30, 2004 resulting in a decrease in gross margin of $21.9 million. Avista Energy’s gross margin (operating revenues less resource costs) was a loss of $4.8 million for the six months ended June 30, 2005 compared to a gain of $17.1 million for the six months ended June 30, 2004. The decrease in gross margin was primarily due to the increase in natural gas prices and the resulting impact on Avista Energy’s natural gas positions, including the effect on the accounting for natural gas storage described above.

Net realized gains decreased to $12.5 million for the six months ended June 30, 2005 from $20.6 million for the six months ended June 30, 2004. Net realized gains represent the net gains on contracts that have settled. The decrease in net realized gains was due to increased net losses on physical natural gas transactions and decreased net gains on physical electric transactions, partially offset by increased net gains on settled financial transactions. The total mark-to-market adjustment for Energy Marketing and Resource Management was a net unrealized loss of $17.3 million for the six months ended June 30, 2005 compared to a net unrealized loss of $3.4 million for the six months ended June 30, 2004. The net unrealized loss for the six months ended June 30, 2005 was primarily due to realization of physical electric transactions and natural gas price movements that were unfavorable to Avista Energy’s positions. During the six months ended June 30, 2005, the change in the total net unrealized gain attributable to market prices and other market changes was a loss of $2.8 million, a decrease from a gain of $14.2 million for the six months ended June 30, 2004.

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Energy trading activities and positions

The following table summarizes information with respect to Avista Energy's trading activities during the six months ended June 30, 2005 (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, 2004	$ 58,965	$ 11,341	$ 70,306
Less contracts settled during 2005 (1)	(32,184)	19,690	(12,494)
Fair value of new contracts when entered into during 2005 (2)	—	—	—
Change in fair value due to changes in valuation techniques (3)	—	—	—
Change in fair value attributable to market prices and other market changes	18,070	(20,911)	(2,841)
Fair value of contracts as of June 30, 2005	$ 44,851	$ 10,120	$ 54,971

(1) Contracts settled during the six months ended June 30, 2005 include those contracts that were open in 2004 but settled during the six months ended June 30, 2005 as well as new contracts entered into and settled during the six months ended June 30, 2005. Amount represents net realized gains associated with these settled transactions.

(2) Avista Energy did not enter into any origination transactions during the six months ended June 30, 2005 in which dealer profit or mark-to-market gain or loss was recorded at inception.

(3) During the six months ended June 30, 2005, Avista Energy did not experience a change in fair value as a result of changes in valuation techniques.

The following table discloses summarized information with respect to valuation techniques and contractual maturities of Avista Energy's energy commodity contracts outstanding as of June 30, 2005 (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)	$32,068	$ 20,423	$ —	$ —	$52,491
Fair value based on valuation models (2)	(1,610)	(1,992)	14,046	(18,084)	(7,640)
Total electric assets (liabilities), net	$30,458	$ 18,431	$ 14,046	$(18,084)	$44,851
Natural gas assets (liabilities), net					
Prices from other external sources (1)	$ 5,023	$ 7,161	$ —	$ —	$12,184
Fair value based on valuation models (3)	(1,980)	(231)	147	—	(2,064)
Total natural gas assets (liabilities), net	$ 3,043	$ 6,930	$ 147	$ —	$10,120

(1) Fair value is determined 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. These 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). Avista Energy performs 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. These internally developed market curves are based upon published New York Mercantile Exchange prices, as well as basis spreads using historical and broker estimates.

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Avista Advantage

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

Net income for Avista Advantage was $0.9 million for the three months ended June 30, 2005 compared to a net loss of $0.4 million for the three months ended June 30, 2004. Operating revenues for Avista Advantage increased $2.2 million and operating expenses increased $0.2 million as compared to the three months ended June 30, 2004. The increase in operating revenues was primarily due to the expansion of Avista Advantage's customer base. Avista Advantage had a 40 percent increase in the number of billed sites as of June 30, 2005 as compared to June 30, 2004. The increase in operating expenses over 2004 primarily reflects increased labor costs necessary to serve an expanding customer base, partially offset by increased efficiencies and the settlement of an employment contract during 2004. Avista Advantage's cost of processing a bill decreased 6 percent for the three months ended June 30, 2005 as compared to the three months ended June 30, 2004.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

Net income for Avista Advantage was $1.7 million for the six months ended June 30, 2005 compared to a net loss of $0.4 million for the six months ended June 30, 2004. Operating revenues for Avista Advantage increased $4.2 million and operating expenses increased $0.8 million as compared to the six months ended June 30, 2004. The increase in operating revenues was primarily due to the expansion of Avista Advantage's customer base. The increase in operating expenses over 2004 primarily reflects increased labor costs necessary to serve an expanding customer base, partially offset by increased efficiencies and the settlement of an employment contract during 2004.

Other

The Other business segment includes Avista Ventures (including AM&D), Pentzer, Avista Development and certain other operations of Avista Capital.

Three months ended June 30, 2005 compared to the three months ended June 30, 2004

The net loss from this business segment was $0.5 million for the three months ended June 30, 2005 compared to a net loss of $0.1 million for the three months ended June 30, 2004. The increase in the net loss was primarily due to the gain on sale of non-operating assets during the three months ended June 30, 2004.

Six months ended June 30, 2005 compared to the six months ended June 30, 2004

The net loss from this business segment was $1.7 million for the six months ended June 30, 2005 compared to a net loss of $1.8 million (excluding the cumulative effect of accounting change) for the six months ended June 30, 2004. The decrease in the net loss was primarily due to a decrease in losses on certain investments of Avista Ventures not related to AM&D and the accrual of an environmental liability during the first half of 2004. This was partially offset by an increase in the net loss for AM&D, which was $0.6 million for the six months ended June 30, 2005 compared to $0.3 million for the six months ended June 30, 2004.

New Accounting Standards

See "Note 2 of the Notes to Consolidated Financial Statements."

Critical Accounting Policies and 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. These estimates and assumptions are based on historical experience and other factors that are believed to be reasonable under the circumstances based on the judgment of the Company's management. 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. The Company's critical accounting policies that require the use of estimates and assumptions were discussed in detail in the 2004 Form 10-K and have not changed materially from that discussion.

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Liquidity and Capital Resources

Review of Cash Flow Statement

Overall During the six months ended June 30, 2005, positive cash flows from operations of $88.7 million, proceeds from the sale of the Company's South Lake Tahoe natural gas distribution properties of $15.6 million and an overall reduction in the Company's consolidated cash position of $15.9 million were used to fund the majority of the Company's cash requirements, including utility capital expenditures of $115.3 million and dividends of $13.1 million. The amount outstanding under Avista Corp.'s five-year $350.0 million committed line of credit increased from $68.0 million to $108.0 million during the six months ended June 30, 2005 to primarily fund $26.0 million of debt redemptions and $8.9 million of debt maturities.

Operating Activities Net cash provided by continuing operating activities was $88.7 million for the six months ended June 30, 2005 compared to $97.1 million for the six months ended June 30, 2004. Power and natural gas cost amortizations, net of deferrals, were $18.7 million for the six months ended June 30, 2005 compared to $4.3 million for the six months ended June 30, 2004. This was primarily due to decreased deferrals of power costs (and a corresponding decrease in cash paid for electric resources) and increased amortization of natural gas costs (and a corresponding increase in cash received from customers), partially offset by decreased amortization of deferred power costs (and a corresponding decrease in cash received from customers). The amortization of deferred power and natural gas costs is substantially matched by an increase in cash revenues collected from customers. Increases in cash resource costs paid for power and natural gas costs are substantially matched by additions to deferred power and natural gas costs. Net cash used in working capital components was $11.0 million for the six months ended June 30, 2005, compared to net cash provided of $8.6 million for the six months ended June 30, 2004. The net cash used during the six months ended June 30, 2005 primarily reflects a decrease in accounts payable (representing cash paid to vendors), a net decrease in the balance outstanding under the Company's revolving accounts receivable sales facility, an increase in natural gas inventory, a decrease in other current liabilities and an increase in cash deposits with counterparties. This was partially offset by a decrease in accounts receivable (representing cash received from customers), a decrease in other current assets and an increase in deposits from counterparties (representing cash received from counterparties). The net cash provided for the six months ended June 30, 2004 primarily reflects a net decrease in accounts receivable (representing cash received from customers). This was partially offset by a net decrease in deposits from counterparties (representing the return of collateral funds), a net decrease in accounts payable (representing cash paid to vendors) and a net decrease in the balance outstanding under the Company's revolving accounts receivable sales facility. Significant changes in non-cash items included a $13.9 million change in energy commodity assets and liabilities, representing the change from an unrealized loss of $3.4 million on energy trading activities for Avista Energy for the six months ended June 30, 2004 to an unrealized loss of $17.3 million for the six months ended June 30, 2005.

Investing Activities Net cash used in continuing investing activities was $96.8 million for the six months ended June 30, 2005, an increase compared to $70.6 million for the six months ended June 30, 2004. The increase was primarily due to an increase in utility property capital expenditures, including $57.5 million for the purchase of Mirant Oregon's 50 percent ownership interest in Coyote Springs 2, partially offset by a change in restricted cash. The total acquisition cost of $62.5 million includes $5.0 million paid in 2004. During the six months ended June 30, 2005, the Company received $15.6 million for the sale of its South Lake Tahoe natural gas distribution properties.

Financing Activities Net cash used in continuing financing activities was $7.7 million for the six months ended June 30, 2005 compared to $21.0 million for the six months ended June 30, 2004. During the six months ended June 30, 2005, short-term borrowings increased $40.0 million, which reflects an increase in the amount of debt outstanding under Avista Corp.'s line of credit. During the six months ended June 30, 2005, Avista Corp. redeemed a total of $26.0 million of medium-term notes scheduled to mature in future years and $8.9 million of long-term debt matured. During the six months ended June 30, 2004, short-term borrowings increased $12.0 million, which primarily reflects an increase in the amount of debt outstanding under Avista Corp.'s line of credit. During the six months ended June 30, 2004, the Company repurchased $16.2 million of long-term debt scheduled to mature in future years at a total premium of $3.0 million.

Overall Liquidity

The Company's consolidated operating cash flows are primarily derived from the operations of Avista Utilities and Avista Energy. The primary source of operating cash flows for Avista Utilities 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 operations include the purchase of electricity and natural gas, other operating expenses, taxes and interest.

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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.

Operating cash flows do not always fully support the capital expenditure needs of Avista Utilities. As such, from time to time, the Company may need to access capital markets in order to fund these needs as well as fund maturing debt. See further discussion at "Capital Resources."

The Company designs operating and capital budgets to control operating costs and capital expenditures. In addition to operating expenses, the Company has continuing commitments for capital expenditures for construction, improvement and maintenance of facilities. In 2001, the Company incurred substantial levels of indebtedness, both short and long-term, to fund high power and natural gas costs in addition to these continuing requirements and to otherwise maintain adequate levels of working capital. As a result of improved operating cash flow and other sources of funds, since 2002 through June 30, 2005, the Company has repurchased $318.7 million of long-term debt.

The general rate increases that became effective in 2002, 2003 and 2004 are allowing the Company to continue to improve its liquidity. The 2002 general electric rate increase in Washington provided for the restructuring and continuation of previously approved temporary rate increases totaling 31.2 percent. In 2003, the Company received a general rate increase, designed to increase annual revenues by $6.3 million in Oregon. In September 2004, the Company received general rate increases, designed to increase base annual revenues by $24.7 million for electric and $3.3 million for natural gas service in Idaho. The Idaho base electric rate increase was substantially offset by a decrease in the PCA surcharge and other minor adjustments such that the net increase in revenues is designed to be $3.2 million. However, the increase in base electric rates will have a significant effect on recurring retail revenues and liquidity. In November 2004, a natural gas general rate increase, designed to increase annual revenues by $5.4 million, was implemented in Washington. In March 2005, the Company filed a request designed to increase annual revenues by $38.7 million in Washington. See further details in the section "Avista Utilities - Regulatory Matters."

When Avista Utilities' power and natural gas costs exceed the levels currently recovered from retail customers, its net cash flows are negatively affected. Factors that could cause purchased power costs to exceed the levels currently recovered from customers include, but are not limited to, higher prices in wholesale markets combined with an increased need to purchase power in the wholesale markets. Factors beyond the Company's 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 hydroelectric resources, outages at generating facilities and failure of third parties to deliver on energy or capacity contracts. Based on forecasts as of July 2005, Avista Utilities expects hydroelectric generation will be approximately 94 percent of normal in 2005, based upon the forecast of below normal precipitation and streamflows for the remainder of the year. This forecast may change based upon precipitation, temperatures and other variables. The expected reduction in hydroelectric generation is not expected to have a significant negative effect on operating cash flows or earnings for 2005 from the amount originally forecasted.

Capital Resources

The Company's consolidated capital structure, including the current portion of long-term debt and short-term borrowings consisted of the following as of June 30, 2005 and December 31, 2004 (dollars in thousands):

	June 30, 2005		December 31, 2004	
	Amount	Percent of total	Amount	Percent of total
Current portion of long-term debt	$ 77,550	3.9%	$ 85,432	4.4%
Short-term borrowings	108,503	5.5	68,517	3.5
Long-term debt to affiliated trusts	113,403	5.8	113,403	5.8
Long-term debt	874,711	44.4	901,556	46.2
Total debt	1,174,167	59.6	1,168,908	59.9
Preferred stock-cumulative (including current portion)	29,750	1.5	29,750	1.5
Total liabilities	1,203,917	61.1	1,198,658	61.4
Stockholders' equity	765,159	38.9	753,205	38.6
Total	$1,969,076	100.0%	$1,951,863	100.0%

The Company's total debt increased from December 31, 2004 to June 30, 2005 due to an increase in short-term borrowings, partially offset by the redemption and maturity of long-term debt. The Company needs to finance capital expenditures and obtain additional working capital from time to time. The cash requirements needed to service

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 corporate requirements. The Company's stockholders' equity increased $12.0 million during the six months ended June 30, 2005 primarily due to net income and the issuance of common stock through the Dividend Reinvestment Plan, partially offset by dividends and other comprehensive loss.

The Company generally funds 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 utility operating activities and cash generated by Avista Energy are expected to be the Company's primary sources of funds for operating needs, dividends and capital expenditures for 2005. Borrowings under Avista Corp.'s committed line of credit may supplement these funds to the extent necessary.

On December 17, 2004, the Company entered into a five-year committed line of credit with various banks in the amount of $350.0 million with an expiration date of December 16, 2009. This committed line of credit replaced a $350.0 million committed line of credit with a 364-day term that had an expiration date of May 5, 2005. The Company can request the issuance of up to $150.0 million in letters of credit under the committed line of credit. As of June 30, 2005 and December 31, 2004, the Company had $108.0 million and $68.0 million, respectively, of borrowings outstanding. As of June 30, 2005 and December 31, 2004, there were $20.0 million and $32.8 million in letters of credit outstanding, respectively. The committed line of credit is secured by $350.0 million of non-transferable First Mortgage Bonds of the Company 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 the Company defaults on its obligations under the committed line of credit. However, if the Company obtains an investment grade senior unsecured rating with a stable outlook from two nationally recognized rating agencies, it has the option to release such security.

The committed line of credit agreement contains customary covenants and default provisions, including covenants not to 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. As of June 30, 2005, the Company was in compliance with this covenant with a ratio of 59.6 percent. The committed line of credit also has a covenant requiring the ratio of "earnings before interest, taxes, depreciation and amortization" to "interest expense" of Avista Utilities for the twelve-month period ending June 30, 2005 to be greater than 1.6 to 1. As of June 30, 2005, the Company was in compliance with this covenant with a ratio of 2.56 to 1.

Any default on the line of credit or other financing arrangements of Avista Corp. or any of its 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, and could induce vendors and other counterparties to demand collateral. In the event of any such default, it would be difficult for the Company to obtain financing on reasonable terms to pay creditors or fund operations, and the Company would likely be prohibited from paying dividends on its common stock. Avista Corp. does not guarantee the indebtedness of any of its subsidiaries. As of June 30, 2005, Avista Corp. and its subsidiaries were in compliance with all of the covenants of their financing agreements.

In April 2004, the Company filed an amended registration statement on Form S-3 with the Securities and Exchange Commission, which would allow for the issuance of up to $349.6 million of securities (either debt or common stock). This filing amended and combined three previous registration statements filed by the Company. As of June 30, 2005, the Company had remaining availability of $259.6 million under this registration statement.

Inter-Company Debt; Subordination

As part of its on-going cash management practices and operations, Avista Corp. from time to time makes unsecured short-term loans to, and obtains borrowings from, Avista Capital. In turn, Avista Capital from time to time makes unsecured short-term loans to, and obtains borrowings from, its subsidiaries. As of June 30, 2005, Avista Corp. held a short-term subordinated note receivable from Avista Capital in the principal amount of $40.9 million. In addition, Avista Capital from time to time guarantees the indebtedness and other obligations of its subsidiaries. See "Energy Marketing and Resource Management Operations" for further information.

Pension Plan

As of June 30, 2005, the Company's pension plan had assets with a fair value that was less than the present value of the accumulated benefit obligation under the plan. The Company does not expect the current pension plan funding deficit to have a material adverse effect on its financial condition, results of operations or cash flows. The Company

made $15 million in cash contributions to the pension plan in 2004. The Company expects to make pension plan contributions of $15 million in 2005 ($7.5 million was contributed during the six months ended June 30, 2005).

Off-Balance Sheet Arrangements

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 22, 2005, 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 May 29, 2005 to March 21, 2006. 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 operating expenses of Avista Corp. As of June 30, 2005, $56.0 million in accounts receivables were sold under this revolving agreement. This agreement provides the Company with cost-effective funds for working capital requirements, capital expenditures and other general corporate needs.

WP Funding LP

WP Funding LP is an entity that was formed in 1993 for the purpose of acquiring the natural gas-fired combustion turbine generating facility in Rathdrum, Idaho (Rathdrum CT). FIN 46 required the Company to consolidate WP Funding LP effective for the period ended December 31, 2003 and thereafter. WP Funding LP purchased the Rathdrum CT from Avista Corp. with funds provided by unrelated investors of which 97 percent represented debt and 3 percent represented equity. Avista Corp. operates the Rathdrum CT and leases it from WP Funding LP. The total amount of WP Funding LP debt outstanding was $54.6 million as of June 30, 2005, which matures in October 2005. In June 2005, Avista Corp. provided notice that it will terminate the lease and acquire the Rathdrum CT from WP Funding LP in September 2005 at a price of $56.3 million representing the "adjusted acquisition cost" pursuant to the lease agreement. Avista Corp. is evaluating funding options with respect to the acquisition of the Rathdrum CT and currently expects to ultimately issue long-term debt. However, Avista Corp. currently plans to fund the acquisition with its committed line of credit on an interim basis.

Credit Ratings

The following table summarizes the Company's credit ratings as of August 1, 2005:

	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	Stable	Stable	Stable

(1) Only assets are subordinated debentures of Avista Corporation.

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.

Dividends

The Board of Directors considers the level of dividends on the Company's common stock on a regular basis, taking into account numerous factors including, without limitation, the Company's results of operations, cash flows and financial condition, as well as the success of the Company's strategies and general economic and competitive conditions. The Company's net income available for dividends is derived primarily from the operations of Avista Utilities and Avista Energy.

AVISTA CORPORATION

Covenants under the Company's 9.75 percent Senior Notes that mature in 2008 limit the Company's ability to increase its common stock cash dividend to no more than 5 percent over the previous quarter.

Avista Energy holds a significant portion of cash and cash equivalents reflected on the Consolidated Balance Sheets. Covenants in Avista Energy's credit agreement, certain counterparty agreements and current market liquidity conditions result in Avista Energy maintaining certain levels of cash and therefore effectively limiting the amount of cash dividends that are available for distribution to Avista Capital and ultimately to Avista Corp. During the six months ended June 30, 2005, Avista Energy paid $15.1 million in dividends to Avista Capital.

Avista Utilities Operations

In January 2005, the Company completed the purchase of Mirant Oregon's 50 percent ownership interest in Coyote Springs 2 at a price of $62.5 million, which includes $5.0 million paid in 2004.

In April 2005, Avista Corp. completed the sale of its South Lake Tahoe natural gas distribution properties to Southwest Gas Corporation. The cash received for the properties was approximately $15.6 million. See "Note 12 of the Notes to Consolidated Financial Statements" for further information.

As of June 30, 2005, Avista Utilities had $18.9 million in cash and temporary investments, as well as $8.7 million of restricted cash. The restricted cash relates to deposits for Avista Corp.'s interest rate swap agreements.

Avista Utilities held cash deposits from other parties in the amount of $13.1 million as of June 30, 2005, which is included in cash and cash equivalents with a corresponding amount 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 7, 8 and 9 of Notes to Consolidated Financial Statements" for additional details related to financing activities.

Energy Marketing and Resource Management Operations

On July 13, 2005, Avista Energy and its subsidiary, Avista Energy Canada, as co-borrowers, amended its committed credit agreement with a group of banks to increase the aggregate amount from $110.0 million to $145.0 million and to extend the expiration date to July 12, 2007. 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 amendment to the credit agreement increased the maximum amount for cash advances from $30.0 million to $50.0 million. No cash advances were outstanding as of June 30, 2005 and December 31, 2004. Letters of credit in the aggregate amount of $85.4 million and $91.3 million were outstanding as of June 30, 2005 and December 31, 2004, respectively. The cash deposits of Avista Energy at the respective banks collateralized $8.2 million and $21.5 million of these letters of credit as of June 30, 2005 and December 31, 2004, respectively, which is reflected as restricted cash on the Consolidated Balance Sheets.

The Avista Energy credit agreement continues to contain 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 continues to contain 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 current 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 June 30, 2005. Prior to the July 13, 2005 amendment, a reduction in the credit rating of Avista Corp. would have represented an event of default under Avista Energy's credit agreement. The July 13, 2005 amendment to the credit agreement removed this covenant.

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

$34.7 million as of June 30, 2005. The face value of all performance guarantees issued by Avista Capital for energy trading contracts at Avista Energy was $390.3 million as of June 30, 2005.

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 six months ended June 30 2005, Avista Energy's maximum total outstanding short-term loan to Avista Capital was $40.2 million including accrued interest. As of June 30, 2005, 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 $43.1 million as of June 30, 2005. Avista Energy held cash deposits from other parties in the amount of $6.4 million as of June 30, 2005, which is included in cash and cash equivalents with a corresponding amount 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.

As of June 30, 2005, Avista Energy had $52.1 million in cash, as well as $11.8 million of restricted cash.

During the six months ended June 30, 2005, Avista Energy paid $15.1 million in dividends to Avista Capital.

Contractual Obligations

During the six months ended June 30, 2005, the Company's future contractual obligations have not changed materially from the amounts disclosed in the 2004 Form 10-K with the following exceptions:

Short-term debt of Avista Utilities (representing borrowings under Avista Corp.'s $350.0 million committed line of credit) increased from $68.0 million as of December 31, 2004 to $108.0 million as of June 30, 2005.

The amount outstanding under Avista Utilities' revolving accounts receivable sales financing facility decreased from $72.0 million as of December 31, 2004 to $56.0 million as of June 30, 2005. In March 2005, the termination date was extended from May 29, 2005 to March 21, 2006.

During the six months ended June 30, 2005, Avista Corp. redeemed a total of $26.0 million of medium-term notes scheduled to mature in future years.

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 June 30, 2005 (dollars in millions):

For the 12-month periods ended June 30,	2006	2007	2008	2009	2010	Thereafter
Energy purchase contracts	$ 967	$ 346	$ 185	$ 189	$ 178	$ 435

Avista Energy also has sales commitments related to these contractual obligations in future periods.

As of June 30, 2005, Avista Corp. did not have any commitments outstanding with equity triggers. Avista Corp. does not expect any material impact from rating triggers; although there are certain rating triggers for Avista Corp. primarily related to changes in pricing under certain financing agreements. Prior to the July 13, 2005 amendment, a reduction in the credit rating of Avista Corp. would have represented an event of default under Avista Energy's credit agreement. The July 13, 2005 amendment to the credit agreement removed this covenant.

Business Risk

The Company's operations are exposed to risks including, but not limited to, the price and supply of purchased 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, the Company's facilities and operations may be exposed to terrorism risks or other malicious acts. See further reference to risks and uncertainties under "Forward-Looking Statements."

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Avista Utilities has mechanisms in each regulatory jurisdiction, which provide for the recovery of the majority of the changes in its power and natural gas costs. The majority of power and natural gas costs that exceed the amount currently recovered through retail rates, excluding the $9.0 million threshold for power costs in Washington, are deferred on the Consolidated Balance Sheets for the opportunity of recovery through future retail rates. These deferred power and natural gas costs are subject to review for prudence and recoverability and as such certain deferred costs may be disallowed by the respective regulatory agencies.

Hydroelectric generation was 95 percent of normal in 2004. Forecasts as of July 2005 indicate that hydroelectric generation will be approximately 94 percent of normal in 2005 based upon the forecast of below normal precipitation and streamflows for the remainder of the year. This forecast may change based upon precipitation, temperatures and other variables. The earnings impact of these factors is mitigated by regulatory mechanisms that are intended to defer increased power supply costs for recovery in future periods. Avista Utilities is not able to predict how the combination of energy resources, energy loads, prices, rate recovery and other factors will ultimately drive deferred power costs and the timing of recovery of these costs in future periods. See further information at "Avista Utilities - Regulatory Matters."

Challenges facing Avista Utilities' electric operations include, among other things, the timing and approval of the recovery of deferred power costs, changes in the availability of and volatility in the prices of power and fuel, generating unit availability, legislative and governmental regulations, potential tax law changes, customer response to price increases and surcharges, streamflows and weather conditions.

Challenges facing Avista Utilities' natural gas operations include, among other things, volatility in the price of natural gas, changes in the availability of natural gas, legislative and governmental regulations, weather conditions and the timing and approval of recovery for increased commodity costs. Avista Utilities' natural gas business also faces the potential for certain natural gas customers to by-pass its natural gas system. To reduce the potential for such by-pass, Avista Utilities prices its natural gas services, including transportation contracts, competitively and has varying degrees of flexibility to price its transportation and delivery rates by means of individual contracts, subject to state regulatory review and approval. Avista Utilities has long-term transportation contracts with several of its largest industrial customers, which reduces the risk of these customers by-passing the system in the foreseeable future.

In addition to its asset management activities, Avista Energy trades electricity and natural gas, along with derivative commodity instruments, including futures, options, swaps and other contractual arrangements. As a result of these trading activities, Avista Energy is subject to various risks including commodity price risk and credit risk, as well as possible risks resulting from the imposition of market controls by federal and state agencies. The FERC is conducting proceedings and investigations related to market controls within the western United States that include proposals by certain parties to impose refunds. As a result, certain parties have asserted claims for significant refunds from Avista Energy and lesser refunds from Avista Utilities, which could result in liabilities for refunding revenues recognized in prior periods. Avista Energy and Avista Utilities have joined other parties in opposing these proposals. The refund proceedings provide that any refunds owed could be offset against unpaid energy debts due to the same party. As of June 30, 2005, Avista Energy's accounts receivable outstanding related to defaulting parties in California are fully offset by reserves for uncollected amounts and funds collected from defaulting parties. Avista Energy is pursuing recovery of the defaulted obligations. See "Counterparty Defaults," "California Refund Proceeding" and "Pacific Northwest Refund Proceeding" in "Note 11 of the Notes to Consolidated Financial Statements" for further information with respect to the refund proceedings.

In connection with matching loads to available resources and optimizing the use of its assets, Avista Utilities engages in wholesale sales and purchases of electric capacity and energy and, accordingly, is also subject to commodity price risk, credit risk and other risks associated with these activities. Please refer to the 2004 Form 10-K for a description and analysis of commodity price, credit, other operating, interest rate and foreign currency risks.

Risk Management

Risk Policies and Oversight. Avista Utilities and Avista Energy use a variety of techniques to manage risks for their energy resources and wholesale energy market activities. Please refer to the 2004 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 2004 Form 10-K for further discussion of the VAR model. As of June 30, 2005, Avista Energy's estimated

potential one-day unfavorable impact on gross margin as measured by VAR was $0.6 million, compared to $0.4 million as of December 31, 2004. The average daily VAR for the six months ended June 30, 2005 was $0.5 million. The high daily VAR was $0.9 million and the low daily VAR was $0.2 million during the six months ended June 30, 2005. Avista Energy was in compliance with its one-day VAR limits during the six months ended June 30, 2005. Changes in markets inconsistent with historical trends or assumptions used could cause actual results to exceed predicted limits.

Environmental Issues and Other Contingencies

During the first quarter of 2005, the U.S. Congress has reintroduced the Clear Skies Act, which, if ultimately passed, could impose further restrictions on sulfur dioxide, nitrogen oxide and mercury emissions. Other proposals to limit emissions of carbon dioxide have also been introduced. In addition, the EPA has finalized mercury emission regulations that will affect coal-fired generation plants, including Colstrip Units 3 & 4. 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. Compliance with these new and proposed requirements and possible additional legislation or regulations could result in increases in capital expenditures and operating expenses for expanded emission controls at the Company’s thermal generating facilities. The amount of these costs and the impact of the restrictions on the operation of the facilities cannot be estimated at this time.

For other environmental issues and other contingencies see “Note 11 of the Notes to Consolidated Financial Statements.”

Energy Bill

In July 2005, the United States Congress passed a comprehensive energy bill that may substantially affect the regulation of energy companies, including Avista Corp. The President is expected to sign the energy bill into law. Key provisions of the energy bill affecting the Company include, but are not limited to, reform of the hydroelectric licensing process, tax credits for incremental hydroelectric production, repeal of the Public Utility Holding Company Act of 1935 and the implementation of mandatory reliability standards. The energy bill also has provisions related to the future operation and development of transmission systems. The energy bill provides federal support for certain clean power initiatives and renewable energy technologies, including wind power generation. The implementation of the energy bill requires proceedings at the state level and the development of regulations by the FERC, the Department of Energy and other federal agencies. Based on a preliminary assessment, the Company believes the 2005 energy bill will be generally favorable to the Company’s operations. However, the Company is still in the process of reviewing the energy bill in its entirety and determining its ultimate effect on the Company.

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 5 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 material information contained in its filings with the Securities and Exchange Commission is recorded, processed, summarized and reported on a timely and accurate basis. 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 ensuring that material information is recorded, processed, summarized and reported on a timely and accurate basis in the Company’s filings with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

AVISTA CORPORATION

There have been no changes in the Company's internal control over financial reporting that occurred during the second quarter of 2005 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 11 of the Notes to Consolidated Financial Statements" which is incorporated by reference.

Item 4. Submission of Matters to a Vote of Security Holders

The 2005 Annual Meeting of Shareholders of Avista Corp. was held on May 12, 2005. The election of three directors with terms expiring in 2008, the ratification of the appointment of the firm of Deloitte & Touche LLP as the independent registered public accounting firm of the Company for 2005, and the approval of the Company's Long-Term Incentive Plan, as amended, were the only matters voted upon at the meeting. There were 48,473,059 shares of common stock issued and outstanding as of March 11, 2005, the proxy record date, with 43,155,573 shares represented at said meeting. The results of the voting are shown below:

Issue	For	Against or Withheld	Exceptions or Abstain	Broker Non-votes
Election of Directors:				
Roy Lewis Eiguren	40,759,731	2,395,842		
Gary G. Ely	40,264,484	2,891,089		
Jessie J. Knight, Jr.	40,926,730	2,228,843		
Ratification of appointment of Deloitte & Touche, LLP	41,566,864	1,340,316	248,393	
Approval of the Company's Long-Term Incentive Plan, as amended	30,657,098	5,681,876	744,760	6,071,839

The terms of directors Erik J. Anderson, Kristianne Blake, David A. Clack, Jack W. Gustavel, John F. Kelly, Michael L. Noel, Lura J. Powell and R. John Taylor continued.

Item 6. Exhibits

10.1	Avista Corporation Long-Term Incentive Plan (incorporated by reference to Appendix A of the definitive proxy statement filed by Avista Corporation on March 31, 2005).
10.2	Third Amended and Restated Credit Agreement, dated as of July 25, 2003, among Avista Energy, Inc. and Avista Energy Canada Ltd., as Co-Borrowers, and BNP Paribas, as Administrative Agent, Collateral Agent, an Issuing Bank, and a Bank and Fortis Capital Corp. as Documentation Agent, an Issuing Bank, and a Bank and Natexis Banques Populaires as a Bank and the other financial institutions which may become parties thereto*
10.3	First Amendment to Third Amended and Restated Credit Agreement dated as of July 23, 2004*
10.4	Second Amendment to Third Amended and Restated Credit Agreement dated as of July 13, 2005*
12	Computation of ratio of earnings to fixed charges and preferred dividend requirements*
18	Change in accounting principles*
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.

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AVISTA CORPORATION

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: August 5, 2005

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

Exhibit 10.2

THIRD AMENDED AND RESTATED CREDIT AGREEMENT

Dated to be Effective as of July 25, 2003

among

AVISTA ENERGY, INC.
and
AVISTA ENERGY CANADA LTD.,
as Co-Borrowers,

and

BNP PARIBAS,
as Administrative Agent, Collateral Agent,
an Issuing Bank, and a Bank

and

FORTIS CAPITAL CORP.
as Documentation Agent,
an Issuing Bank, and a Bank

and

NATEXIS BANQUES POPULAIRES
as a Bank

and

THE OTHER FINANCIAL INSTITUTIONS WHICH MAY BECOME PARTIES HERETO

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THIRD AMENDED AND RESTATED CREDIT AGREEMENT

This **THIRD AMENDED AND RESTATED CREDIT AGREEMENT** is entered into effective as of July 25, 2003, among **AVISTA ENERGY, INC.**, a Washington corporation ("Avista") and **AVISTA ENERGY CANADA LTD**., a corporation of the province of Alberta, Canada ("Avista Canada") (jointly, severally and collectively, the "Co-Borrowers," and each individually, a "Co-Borrower"), **BNP PARIBAS** ("BNP Paribas") as Administrative Agent, Collateral Agent, an Issuing Bank, and a Bank, **FORTIS CAPITAL CORP.** ("Fortis") as Documentation Agent, an Issuing Bank, and a Bank, **NATEXIS BANQUES POPULAIRES** ("Natexis") as a Bank, and each other financial institution which may become a party hereto (the "Banks").

WHEREAS, the Co-Borrowers and Bank of America N.A. entered into that certain Second Amended and Restated Credit Agreement dated to be effective as of June 29, 2001 (as amended, modified and supplemented from time to time, the "Existing Credit Agreement"); and

WHEREAS, the Banks and the Co-Borrowers desire again to amend and restate the Existing Credit Agreement in its entirety.

NOW, THEREFORE, in consideration of the mutual agreements, provisions and covenants contained herein, the Existing Credit Agreement is amended and restated in its entirety as follows:

ARTICLE I

DEFINITIONS

1.01 Certain Defined Terms. The following terms have the following meanings:

"Account" has the meaning stated in the New York Uniform Commercial Code.

"Account Debtor" means a Person who is obligated to a Co-Borrower under an Account of such Co-Borrower.

"Acquisition" means any transaction or series of related transactions for the purpose of or resulting, directly or indirectly, in (a) the acquisition of all or substantially all of the assets of a Person, or of any business or division of a Person, (b) the acquisition of in excess of 50% of the capital stock, partnership interests or equity of any Person, or otherwise causing any Person to become a Subsidiary, or (c) a merger or consolidation or any other combination with another Person (other than a Person that is a Subsidiary) provided that the relevant Co-Borrower or the Subsidiary is the surviving entity.

"Activation Period" means the period following receipt by Wells Fargo of an Activation Notice under the Override Agreement during which the Collateral Agent, on

behalf of the Banks, exercises control over the Accounts specified in the Override Agreement.

"Administrative Agent" means BNP Paribas.

"Administrative Agent's Payment Office" means the address for payments set forth on Schedule 11.02 hereto in relation to the Administrative Agent, or such other address as the Administrative Agent may from time to time specify.

"Adjusted Net Working Capital" means the sum of (i) Net Working Capital, (ii) cash securing Letters of Credit issued under the Collateralized L/C Line, and (iii) fifty percent (50%) of the amount of any loans made by either of the Co-Borrowers to Avista Capital).

"Adjusted Pro Rata Share" means, as to any Bank at any particular time, the percentage equivalent (expressed as a decimal, rounded to the ninth decimal place) at such time of (a) an amount equal to such Bank's Line Portion plus, in the case of BNP Paribas or any of its affiliates, the amount of advances made by way of Daylight Overdrafts which have not been reimbursed pursuant to Subsection 2.01(c) hereof or otherwise repaid, plus, in the case of each Swap Bank, the amount of obligations (including, without limitation, liquidation obligations) owed to the Swap Banks under Swap Contracts to the extent such obligations have not been paid pursuant to Subsection 2.01(c) hereof, divided by (b) the total amount of the Borrowing Base Line plus the total amount of the Collateralized L/C Line, plus the amount of advances made by way of Daylight Overdrafts which have not been reimbursed pursuant to Subsection 2.01(c) hereof or otherwise repaid, plus the amount of obligations (including, without limitation, liquidation obligations) owed to the Swap Banks under Swap Contracts to the extent such obligations have not been paid pursuant to Subsection 2.01(c) hereof or otherwise, if any.

"Advance Maturity Date" means the maturity date of advances made hereunder which for Base Rate Loans will be the earliest to occur of (a) 90 days from the date of the Borrowing or (b) the Expiration Date, and for Eurodollar Rate Loans will be the end of the Interest Period for such Eurodollar Rate Loan.

"Affiliate" means, as to any Person, any other Person which, directly or indirectly, is in control of, is controlled by, or is under common control with, such Person. A Person shall be deemed to control another Person if the controlling Person possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the other Person, whether through the ownership of voting securities, by contract, or otherwise.

"Agents" means BNP Paribas and Fortis in their capacities as agents for the Banks hereunder, and any successor agents arising under Section 10.09.

“Agent-Related Persons” means BNP Paribas and Fortis and any successor agent arising under Section 10.09, together with their respective Affiliates and the officers, directors, employees, agents and attorneys-in-fact of such Persons and Affiliates.

“Aggregate Credit Exposure Percentage” means, as to any Bank in the event repayment is made to the Banks by a Guarantor or by either Co-Borrower after a declaration of a Default by the Required Banks or made pursuant to a liquidation of Collateral, whether by setoff or otherwise (the date on which such Default is declared, the “determination date”), the decimal equivalent of a fraction,

(A) the numerator of which is equal to (i) the highest amount of such Bank’s outstanding Revolving Loans and Reducing L/C Borrowings following the determination date, plus (ii) the highest amount of such Bank’s participation interest in any L/C Obligations outstanding following the determination date not repaid by Revolving Loans or Overdraft Advances, plus (iii) in the case of BNP Paribas, the highest amount of outstanding advances by way of Daylight Overdrafts which have not been reimbursed pursuant to Subsection 2.01(c) hereof or otherwise repaid, plus (iv) in the case of each Swap Bank, the aggregate amount of Obligations owed to such Swap Bank following the determination date in respect of such Swap Contracts existing on the determination date (including the amounts payable to such Swap Bank upon termination of such Swap Contracts), but only to the extent that other Banks have not purchased participations in such Swap Contracts or such Obligations have not otherwise been repaid (i) by either Co-Borrower or a Guarantor, whether such payment is made utilizing operating cash, cash collateral in an Insolvency Proceeding or otherwise, or (ii) with proceeds of Revolving Loans or Overdraft Advances, and

(B) the denominator of which is the sum of (i) the highest amount of all Banks’ outstanding Revolving Loans and Reducing L/C Borrowings following the determination date, plus (ii) the highest amount of all L/C Obligations outstanding following the determination date not repaid by Revolving Loans or Overdraft Advances, plus (iii) the highest amount of outstanding advances by way of Daylight Overdrafts which have not been reimbursed pursuant to Subsection 2.01(c) hereof or otherwise repaid, plus (iv) the aggregate amount of Obligations owed to the Swap Banks following the determination date in respect of Swap Contracts existing on the determination date (including the amounts payable to the Swap Banks upon termination of the Swap Contracts), but only to the extent that other Banks have not purchased participations in such Swap Contracts or such Obligations have not otherwise been repaid (i) by either Co-Borrower or a Guarantor, whether such payment is made utilizing operating cash, cash collateral in an Insolvency Proceeding or otherwise, or (ii) with proceeds of Revolving Loans or Overdraft Advances.

“Agreement” means this Third Amended and Restated Credit Agreement.

“Applicable Margin” means:

(a) with respect to Base Rate Loans: 0%

(b) with respect to Eurodollar Rate Loans: 1.50%

"Approved Brokerage Accounts" means brokerage accounts maintained by either Co-Borrower with brokerage companies approved by Banks for the purpose of allowing Co-Borrowers to engage in the purchase and sale of commodity futures, commodity options, forward or leverage contracts and/or actual or cash commodities, and subject to a fully perfected first priority security interest in favor of the Collateral Agent for the benefit of the Banks (including a tri-party control agreement, acceptable to the Banks).

"Assignee" has the meaning specified in Subsection 11.08(a).

"Attorney Costs" means and includes all reasonable fees and disbursements of any law firm or other external counsel, the allocated cost of internal legal services and all disbursements of internal counsel.

"Avista Blocked Account" has the meaning specified in Section 7.15.

"Avista Capital" means Avista Capital, Inc., a Washington corporation, the parent company of Avista.

"Avista Corporation" means Avista Corporation, a Washington corporation, the parent company of Avista Capital.

"Bank Blocked Accounts" means (i) account maintained by Avista with Wells Fargo, (ii) multicurrency account maintained by Avista with Wells Fargo and (iii) multicurrency account maintained by Avista Canada with Wells Fargo.

"Bankruptcy Code" means the Federal Bankruptcy Reform Act of 1978, as amended (11 U.S.C. § 101, *et seq.*).

"Banks" shall mean BNP Paribas, Fortis, Natexis and the other lending institutions which have been added to this Agreement pursuant to the amendments to this Agreement. At such time as additional lending institutions are added to this Agreement, either through an amendment to this Agreement or through an Assignment and Acceptance in accordance with Subsection 11.08(a) hereof, the term "Banks" shall include such additional lending institutions.

"Base Rate" means, for any day, the higher of: (a) 0.50% per annum above the latest Federal Funds Rate; or (b) the rate of interest in effect for such day as publicly announced from time to time by BNP Paribas in New York, New York, as its "Prime Rate." (The "Prime Rate" is a rate based upon various factors, including costs and desired return, general economic conditions and other factors, and is used as a reference point for pricing some loans, which may be priced at, above, or below such announced

rate.) Any change in the “Prime Rate” shall take effect at the opening of business on the day specified in the public announcement of such change.

“Base Rate Loan” means any Loan bearing interest based upon the Base Rate.

“Benefit Plan” means an employee benefit plan (as defined in Section 3(3) of ERISA) which a Co-Borrower sponsors or maintains or to which a Co-Borrower makes, is making, or is obligated to make contributions, excluding any Plans.

“BNP Paribas” means BNP Paribas, a bank organized under the laws of France.

“Borrowing” means a borrowing hereunder consisting of Revolving Loans made to the Co-Borrowers on the same day by the Banks under Article II.

“Borrowing Base Cap” means at any time an amount equal to the lesser of:

(a) $110,000,000.00 less L/C Obligations under the Collateralized L/C Line;

(b) the Elected Line Cap; or

(c) the sum of:

(i) (x) 100% of Cash Collateral and other liquid investments having a tenor under 90 days and (y) 95% of Cash Collateral and other liquid investments with tenors beyond 90 days but less than 360 days, which Cash Collateral and other liquid investments listed in (x) and (y) shall be acceptable to the Banks in their sole discretion and which are subject to a first perfected security interest in favor of the Collateral Agent, as collateral agent for the Banks, and which have not been used in determining availability for any other advance or Letter of Credit Issuance or for instruments to hedge Canadian dollar exposure related to purchases and sales of Product; provided that no more than 75% of Cash Collateral and other such liquid investments shall have a tenor between 90 – 180 days; provided, further, that no more than 25% of Cash Collateral and other such liquid investments shall have a tenor between 181 – 360 days; plus

(ii) 90% of Eligible Accounts which are not being used in determining availability for any other Loan or Letter of Credit Issuance net of any Out-of-the-Money Positions by counterparty, not to exceed related amounts included in Eligible Accounts; plus

(iii) 90% of equity (i.e. amounts in excess of margin requirements) in Approved Brokerage Accounts; plus

(iv) 80% of Eligible Exchange Receivables which are not being used in determining availability for any other Loan or Letter of Credit Issuance net of any remaining Out-of-the-Money Positions by counterparty, not to exceed related amounts included in Eligible Exchange Receivables; plus

(v) 80% of Eligible Inventory consisting of natural gas which is not being used in determining availability for any other advance or Letter of Credit Issuance; plus

(vi) 85% of Unbilled Eligible Accounts which are not being used in determining availability for any other Loan or Letter of Credit Issuance net of any remaining Out-of-the-Money Positions by counterparty, not to exceed related amounts included in Unbilled Eligible Accounts; plus

(vii) 80% of Undelivered Product Value; less

(viii) 50% of Posted Collateral; less

(ix) the net amounts due to the Swap Banks under Swap Contracts unless and to the extent such amounts are secured by cash pledges of cash not otherwise included in the Borrowing Base Cap or by a Letter of Credit, less

(x) the US Dollar Equivalent of an amount equal to CDN $650,000, which amount represents potential amounts which may be or become due to Wells Fargo under Canadian dollar checking account services; such amount to be subtracted herein whether or not such amount is due to Wells Fargo under such checking account services, less

(xi) the amounts that would be subject to a so-called “First Purchaser Lien” as defined in Texas Bus. & Com. Code Section 9.343, comparable laws of the states of Oklahoma, Kansas, Wyoming or New Mexico, or any other comparable law, unless a Letter of Credit secures payment of all amounts subject to such First Purchaser Lien.

In no event shall any amounts described in (c)(i) through (c)(vii) above which may fall into more than one of such categories be counted more than once when making the calculation under subsection (c) of this definition.

NOTWITHSTANDING THE FOREGOING, AT NO TIME WILL THE BORROWING BASE CAP BE IN AN AMOUNT IN EXCESS OF THE TOTAL LINE PORTION AMOUNTS AS SET FORTH ON SCHEDULE 2.01 FROM TIME TO TIME.

"Borrowing Base Line" means that certain line of credit in an amount of up to the lesser of (i) $110,000,000.00 or (ii) the amount that at the time of determination is as set forth on Schedule 2.01, which amount is initially $110,000,000.00. The line is for the purpose of (a) providing working capital related to the purchase and resale of Product; (b) providing for Letters of Credit to secure suppliers of Product; (c) to purchase Swap Contracts from time to time; (d) making Daylight Overdrafts and funding payments due to BNP Paribas for unreimbursed Daylight Overdrafts; (e) funding payments due to any Swap Bank or any of its Affiliates under any Swap Contract; and (f) providing for Letters of Credit to support payments owed to counterparties under swap contracts and to support performance obligations to counterparties. Amounts outstanding under the Borrowing Base Line may not exceed the Borrowing Base Cap.

"Borrowing Base Report" means a report detailing all Collateral which has been or is being used in determining availability for an advance or letter of credit issuance under the Borrowing Base Line, such report to be in the form attached hereto as Exhibit E.

"Borrowing Date" means any date on which a Borrowing occurs under Section 2.03.

"Business Day" (a) with respect to all matters other than those related to Eurodollar Rate Loans, means any day other than a Saturday, Sunday or other day on which commercial banks in, New York City and Dallas, Texas are authorized, or in New York City or Dallas, Texas are required, by law to close and (b) means, for purposes of determining business days in connection with Eurodollar Rate Loans, any day on which transactions are made in the applicable offshore dollar interbank market other than a Saturday, Sunday or other day on which commercial banks in New York City and London, England are authorized or required, by law to close.

"California Receivables" mean accounts receivables due from California Power Exchange, Automated Power Exchange and California Independent System Operators, net of specific bad debt reserves established for these receivables.

"Canadian Dollar Equivalent" means, with respect to any Dollars, the amount of such Dollars converted to Canadian dollars computed at BNP Paribas' selling rate for Dollars most recently in effect on or prior to the date of determination.

"Canadian Investment Accounts" means those certain investment accounts maintained by Avista and Avista Canada with Wells Fargo, as such term is defined in the Security Agreements executed by Avista and Avista Canada.

"Capital Adequacy Regulation" means any guideline, request or directive of any central bank or other Governmental Authority, or any other law, rule or regulation, whether or not having the force of law, in each case, regarding capital adequacy of any Bank or of any corporation controlling a Bank.

“Capital Stock” means capital stock, equity interest or other obligations or securities of, or any interest in, any Person.

“Cash Collateral” means currency issued by the United States and Marketable Securities both of which have been Cash Collateralized for the benefit of the Banks.

“Cash Collateralize” means to pledge and deposit with or deliver to the Collateral Agent, for the benefit of the Banks, Cash Collateral as collateral for the Obligations pursuant to documentation in form and substance satisfactory to the Collateral Agent (which documents are hereby consented to by the Banks). The Co-Borrowers hereby grant the Collateral Agent, for the benefit of the Banks, a security interest in all such Cash Collateral. Cash Collateral shall be maintained in the Bank Blocked Accounts, the Paribas Investment Accounts, the Wells Fargo Investment Accounts, or the Canadian Investment Accounts.

“Change of Control” means (i) with respect to Avista, the failure of Avista Capital to own 80% of the Capital Stock and other ownership rights in Avista or the sale, pledge, hypothecation, assignment or other transfer by Avista Capital of any of such ownership rights, in either case, without the prior written consent of the Banks, (ii) with respect to Avista Canada, the failure of Avista to own 100% of the Capital Stock or other ownership rights in Avista Canada or the sale, pledge, hypothecation, assignment or other transfer by Avista of any of such ownership rights, in either case, without the prior written consent of the Banks, and (iii) with respect to Avista Capital, the failure of Avista Corporation to own 100% of the Capital Stock or other ownership rights in Avista Capital or the sale, pledge, hypothecation, assignment or other transfer by Avista Corporation of any of such ownership rights, in either case, without the prior written consent of the Required Banks.

“Closing Date” means the date on which all conditions precedent set forth in Section 5.01 are satisfied or waived by all Banks.

“Co-Borrower” means any individual Co-Borrower.

“Co-Borrowers” means jointly, severally, and collectively, Avista and Avista Canada.

“Co-Borrowers’ Sub-limit” means the individual lines under the Credit Lines for each of the Co-Borrowers as set forth on Schedule 2.01. Amounts utilized under the Dollar Advance Sub-limit, the Overdraft Advance Sub-limit and the Daylight Overdraft Sub-limit reduce the amounts available under the Borrowing Base Line. Further, the aggregate amounts utilized under the Credit Lines may not exceed the Facility Amount.

“Co-Borrowers Sub-limit Portion” means each Bank’s portion of the Co-Borrowers Sub-limits as is set forth on Schedule 2.01 from time to time.

"Code" means the Internal Revenue Code of 1986, and regulations promulgated thereunder.

"Collateral" means all personal property and assets of each of the Co-Borrowers including, without limitation, all accounts, chattel paper, contract rights, deposit accounts, documents, equipment, investment accounts, investment property, instruments, inventory, letter-of-credit rights, natural gas in transit, supporting obligations, the Bank Blocked Accounts, the Wells Fargo Investment Accounts, the Canadian Investment Accounts, stock, partnership interests, and general intangibles, including without limitation payment intangibles, whether presently existing or hereafter acquired or created and the proceeds thereof.

"Collateral Agent" means BNP Paribas.

"Collateralized L/C Line" means that certain line of credit in an amount of up to the lesser of (i) $50,000,000.00 or (ii) the amount that at the time of determination is set forth on Schedule 2.01, which amount is initially $50,000,000.00. The line is for the purpose of providing Cash Collateralized Letters of Credit to (a) support payments owed to counterparties under swap contracts and (b) support purchases of Product under contracts which require letters of credit with tenors of up to two years but with expiration dates not to extend beyond the Maturity Date.

"Compliance Certificate" means a certificate, in form attached hereto as Exhibit C, whereby the Co-Borrowers certify that they are in compliance with this Agreement.

"Contingent Obligation" means, as to any Person, any direct or indirect liability of that Person, whether or not contingent, with or without recourse, (a) with respect to any Indebtedness, lease, dividend, letter of credit or other obligation (the "primary obligations") of another Person (which obligations and Person are referred to herein as the "primary obligation" and the "primary obligor," respectively), including any obligation of that Person (i) to purchase, repurchase or otherwise acquire such primary obligations or any security therefor, (ii) to advance or provide funds for the payment or discharge of any such primary obligation, or to maintain working capital or equity capital of the primary obligor or otherwise to maintain the net worth or solvency or any balance sheet item, level of income or financial condition of the primary obligor, (iii) to purchase property, securities or services primarily for the purpose of assuring the owner of any such primary obligation of the ability of the primary obligor to make payment of such primary obligation, or (iv) otherwise to assure or hold harmless the holder of any such primary obligation against loss in respect thereof (each, a "Guaranty Obligation"); (b) with respect to any Surety Instrument (other than any Letter of Credit) issued for the account of that Person or as to which that Person is otherwise liable for reimbursement of drawings or payments; (c) to purchase any materials, supplies or other property from, or to obtain the services of, another Person if the relevant contract or other related document or obligation requires that payment for such materials, supplies or other property, or for such services, shall be made regardless of whether delivery of such materials, supplies or

other property is ever made or tendered, or such services are ever performed or tendered; or (d) in respect of any agreement, whether or not in writing, relating to any transaction that is a rate swap, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap or option, bond, note or bill option, interest rate option, forward foreign exchange transaction, cap, collar or floor transaction, currency swap, cross-currency rate swap, currency option or any other similar transaction (including any option to enter into any of the foregoing) or any combination of the foregoing and any master agreement relating to or governing any or all of the foregoing.

"Contractual Obligation" means, as to any Person, any provision of any security issued by such Person or of any agreement, undertaking, contract, indenture, mortgage, deed of trust or other instrument, document or agreement to which such Person is a party or by which it or any of its property is bound.

"Conversion/Continuation Date" means any date on which, under Section 2.04, the Co-Borrowers (a) convert Loans of one Type to another Type, or (b) continue such Loans as Loans of the same Type, but with a new Interest Period.

"Copac Management" means Copac Management Inc., a corporation of the Province of Alberta, Canada, a wholly owned subsidiary of Avista Canada.

"Credit Extension" means and includes (a) the making of any Revolving Loans hereunder; or (b) the Issuance of any Letters of Credit hereunder.

"Credit Lines" means the Borrowing Base Line and the Collateralized L/C Line.

"Daylight Overdrafts" means overdrafts extended by BNP Paribas to the Co-Borrowers pursuant to a request by the Co-Borrowers.

"Daylight Overdraft Sub-limit" means that certain Daylight Overdraft Sub-limit under the Borrowing Base Line set forth in Schedule 2.01.

"Default" means any event or circumstance which, with the giving of notice, the lapse of time, or both, would constitute an Event of Default.

"Default Rate" has the meaning specified in Subsection 2.08(a).

"Documentary L/C" means a Letter of Credit which is intended at the time of Issuance to be drawn upon and excludes standby letters of credit.

"Dollar Advance" means any advance under the Borrowing Base Line other than an Overdraft Advance or a Daylight Overdraft.

"Dollar Advance Sub-limit" means a limitation upon Dollar Advances under the Borrowing Base Line equal to $30,000,000.00.

"Dollar Equivalent" of any Canadian dollars shall mean the amount of such Canadian dollars converted to Dollars computed at BNP Paribas' selling rate for Canadian dollars most recently in effect on or prior to the date of determination.

"Dollars", and "$" each mean lawful money of the United States.

"Economic Basis" means the calculation of financial accounting terms using mark to market of certain assets and liabilities as if the accounting standards of the Emerging Issues Task Force (EITF) under EITF-98-10 (accounting for contracts involved in energy trading and risk management activities) still applied.

"Effective Amount" means (a) with respect to any Revolving Loans on any date, the aggregate outstanding principal amount thereof after giving effect to any Borrowings and prepayments or repayments of Revolving Loans occurring on such date; and (b) with respect to any outstanding L/C Obligations on any date, the amount of such L/C Obligations on such date after giving effect to any Issuances of Letters of Credit occurring on such date and any other changes in the aggregate amount of the L/C Obligations as of such date, including changes as a result of expiration or cancellation, any reimbursements of outstanding unpaid drawings under any Letters of Credit or any reductions in the maximum amount available for drawing under Letters of Credit taking effect on such date. In determining the Effective Amount of any Letter of Credit that is denominated in Canadian dollars, Administrative Agent may at any time determine the Dollar Equivalent of such Letter of Credit and if Administrative Agent determines that the Dollar Equivalent is in excess of the U.S. Dollar amounts shown on Administrative Agent's books and records at such time, Administrative Agent may advise the Co-Borrowers. In such event, the Effective Amount of such Letter of Credit shall be deemed to be the Dollar Equivalent amount and Administrative Agent shall record and reflect such revised amount on its books and records.

"Elected Line Cap" means the amount which the Co-Borrowers may elect for purposes of determining availability under the Borrowing Base Line from time to time or at any time, but no more frequently than six (6) times per calendar year, initially zero (0) which amount may be $40,000,000.00, $50,000,000.00, $60,000,000.00, $80,000,000.00, $100,000,000.00, or $110,000,000.00. The Elected Line Cap shall continue in effect until again changed by Co-Borrowers in accordance with this Agreement or until automatically reduced as hereinafter set forth. Notwithstanding the foregoing, the Co-Borrowers may not elect an Elected Line Cap unless Co-Borrowers' Net Working Capital and Net Worth at the time of election are greater than, or equal to, the amounts specified below:

(a) If the Co-Borrowers elect $40,000,000.00, their Net Working Capital must be at least $15,600,000.00 and their Net Worth must be at least $130,000,000.00; or

(b) If the Co-Borrowers elect $50,000,000.00, their Net Working Capital must be at least $17,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(c) If the Co-Borrowers elect $60,000,000.00, their Net Working Capital must be at least $19,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(d) If the Co-Borrowers elect $80,000,000.00, their Net Working Capital must be at least $23,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(e) If the Co-Borrowers elect $100,000,000.00, their Net Working Capital must be at least $27,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(f) If the Co-Borrowers elect $110,000,000.00, their Net Working Capital must be at least $29,000,000.00 and their Net Worth must be at least $130,000,000.00.

The Co-Borrowers shall elect which Elected Line Cap is in effect from time to time by delivering to the Administrative Agent a written notice of such election in the form of Exhibit G which is attached hereto. In the event that after the Co-Borrowers make an Elected Line Cap election, the Co-Borrowers' Net Working Capital or Net Worth as reflected on a Compliance Certificate delivered to the Administrative Agent are not in compliance with the requirements set forth above, the Elected Line Cap shall be automatically reduced to the appropriate level set forth above to cause compliance with the requirements set forth above, provided that if the Co-Borrowers fail to qualify for (b) through (f), then the Elected Line Cap shall be $40,000,000.00. Such reduction shall take place upon Banks' approval of such Compliance Certificate or notice of election. Until such time as the Co-Borrowers elect a different Elected Line Cap, the Elected Line Cap shall remain unchanged unless the Co-Borrowers fail to comply with the requirements set forth above.

"Eligible Accounts" means, at the time of any determination thereof, each of the Co-Borrowers' Accounts as to which the following requirements have been fulfilled to the satisfaction of all the Banks:

(a) Such Account (if for an amount in excess of $750,000.00) either (i) is the result of a sale to an Account Debtor who has been pre-approved for such purpose by all the Banks, in writing, in their sole discretion, or (ii) is secured by letters of credit in form acceptable to the Banks in their sole discretion and issued by banks approved by all the Banks in their sole discretion;

(b) Such Co-Borrower has lawful and absolute title to such Account;

(c) Such Account is a valid, legally enforceable obligation of the Person who is obligated under such Account for goods actually delivered to such Account Debtor in the ordinary course of such Co-Borrower's business;

(d) Such Account shall have excluded therefrom any portion that is subject to any dispute, offset, counterclaim or other claim or defense on the part of the Account Debtor or to any claim on the part of the Account Debtor denying liability under such Account; provided, however, that in the event that the portion that is subject to any such dispute, offset, counterclaim or other claim or defense is secured with a Letter of Credit, such portion secured by the Letter of Credit shall not be excluded;

(e) Such Account is not evidenced by any chattel paper, promissory note or other instrument;

(f) Such Account (and any letter of credit securing it) is subject to a fully perfected first priority security interest (or properly filed and acknowledged assignment, in the case of U.S. government contracts, if any) in favor of Administrative Agent pursuant to the Loan Documents, prior to the rights of, and enforceable as such against, any other Person, and such Account is not subject to any security interest or Lien in favor of any Person other than the Liens of the Banks pursuant to the Loan Documents;

(g) Such Account shall have excluded therefrom (i) any portion which is not payable in Dollars in the U.S. or Canadian dollars in Canada or the U.S., and (ii) one percent (1%) of any portion which is so payable in Canadian dollars;

(h) Such Account is due and payable within 30 days or less (or 60 days or less, if the Account Debtor is a governmental entity) from the date of the invoice and payment thereof is not delinquent, and no extension or indulgence has been granted extending the due date beyond a 30 day period (or 60 days, as the case may be), except if such Account by its terms provides for a 30 day payment period, then such Account shall be eligible for up to 45 days from the date of invoice;

(i) No Account Debtor in respect of such Account is (i) an Affiliate of either Co-Borrower, or (ii) incorporated in or primarily conducting business in any jurisdiction outside of the U.S. or Canada, unless such Account Debtor and the Account is approved in writing by all the Banks; and

(j) No Account Debtor in respect of such Account is insolvent or subject to an Insolvency Proceeding.

"Eligible Assignee" means (a) a commercial bank organized under the laws of the United States, or any state thereof, and having a combined capital and surplus of at least $100,000,000.00; (b) a commercial bank organized under the laws of any other country

which is a member of the Organization for Economic Cooperation and Development (the "OECD"), or a political subdivision of any such country, and having a combined capital and surplus of at least $100,000,000.00, provided that such bank is acting through a branch or agency located in the United States; and (c) any Bank or a Person that is primarily engaged in the business of commercial lending and that is (i) a Subsidiary of a Bank, (ii) a Subsidiary of a Person of which a Bank is a Subsidiary, or (iii) a Person of which a Bank is a Subsidiary.

"Eligible Exchange Receivables" means all enforceable rights of a Co-Borrower to receive Product in the ordinary course of business in exchange for the sale or trade of Product previously delivered to the exchange debtor by such Co-Borrower which (a) are evidenced by a written agreement enforceable against the exchange debtor thereof, (b) are current pursuant to the terms of the contract or invoice, (c) are subject to a perfected, first Lien in favor of the Administrative Agent for the benefit of the Banks subject only to Permitted Liens, and no other Lien, charge, offset, defense, counterclaim or claim, (d) are not the subject of a dispute between the exchange debtor and such Co-Borrower, (e) are valued at Platt's spot market price or an independent posting acceptable to all the Banks in their sole discretion, (f) if arising pursuant to contracts involving an amount in excess of $750,000, are contracts by exchangers pre-approved by all the Banks in their sole discretion, or contracts secured by letters of credit in form acceptable to all the Banks in their sole discretion and issued by banks approved by all the Banks in their sole discretion, and (g) have not been otherwise determined by any of the Banks in their sole discretion to be unacceptable to them. The Product and Account relating to or creating any Eligible Exchange Receivable shall not be simultaneously included in any other availability calculation, including, without limitation, Undelivered Product Value, Eligible Inventory or Eligible Accounts. No Exchange Receivable shall be considered an Eligible Exchange Receivable if the exchange debtor in respect of such Exchange Receivable is insolvent or subject to an Insolvency Proceeding.

"Eligible Inventory" means, at the time of determination thereof, all of each Co-Borrower's natural gas inventory stored in terminals (and provided the Banks must have approved all terminal owners) valued at current market price (as referenced by a published source acceptable to all the Banks in their sole discretion), and in all instances as to which the following requirements have been fulfilled to the satisfaction of all the Banks:

(i) The inventory is owned by such Co-Borrower free and clear of all Liens in favor of third parties, except Liens in favor of the Administrative Agent for the benefit of the Banks under the Loan Documents and except for Permitted Liens;

(ii) The inventory has not been identified to deliveries with the result that a buyer would have rights to the inventory that would be superior to the Administrative Agent's security interest, nor shall such inventory have become the subject of a customer's ownership or Lien;

(iii) The inventory is in transit in the U.S. or Canada under the control and ownership of such Co-Borrower or is in a pipeline or a bill of lading has been issued to the Administrative Agent if such inventory is in the hands of a third party carrier or is located in the U.S. at the locations described on Schedule 7.03(f), or at such other place as has been specifically agreed to in writing by all the Banks and such Co-Borrower; and

(iv) The inventory is subject to a fully perfected first priority security interest in favor of the Administrative Agent for the benefit of the Banks pursuant to the Loan Documents.

"Eligible Subordinated Debt" means Subordinated Debt not to exceed 50% of (i) the minimum Net Working Capital required under Section 8.12(a) or, if greater, (ii) the level of Net Working Capital for the Elected Line Cap in effect at the time the Subordinated Debt is incurred.

"Environmental Claims" means all claims, however asserted, by any Governmental Authority or other Person alleging potential liability or responsibility for violation of any Environmental Law, or for release or injury to the environment.

"Environmental Laws" means all federal, state or local laws, statutes, common law duties, rules, regulations, ordinances and codes, together with all administrative orders, directed duties, requests, licenses, authorizations and permits of, and agreements with, any Governmental Authorities, in each case relating to environmental, health, safety and land use matters.

"ERISA" means the Employee Retirement Income Security Act of 1974, and regulations promulgated thereunder.

"ERISA Affiliate" means any trade or business (whether or not incorporated) under common control with a Co-Borrower within the meaning of Section 414(b) or (c) of the Code (and Sections 414(m) and (o) of the Code for purposes of provisions relating to Section 412 of the Code).

"ERISA Event" means (a) a Reportable Event with respect to a Plan; (b) a withdrawal by a Co-Borrower or any ERISA Affiliate from a Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer (as defined in Section 4001(a)(2) of ERISA) or a cessation of operations which is treated as such a withdrawal under Section 4062(e) of ERISA; (c) a complete or partial withdrawal by a Co-Borrower or any ERISA Affiliate from a Multiemployer Plan or notification that a Multiemployer Plan is in reorganization; (d) the filing of a notice of intent to terminate, the treatment of a Plan amendment as a termination under Section 4041 or 4041A of ERISA, or the commencement of proceedings by the PBGC to terminate a Plan or Multiemployer Plan; (e) the receipt of a written or oral statement by the PBGC which might reasonably be expected to constitute or indicate grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Plan or

Multiemployer Plan; or (f) the imposition of any material liability under Title IV of ERISA, other than PBGC premiums due but not delinquent under Section 4007 of ERISA, upon a Co-Borrower or any ERISA Affiliate.

"Eurodollar Effective Amount" means the product of the principal amount of a Eurodollar Rate Loan or requested Eurodollar Rate Loan and the number of days in the applicable Interest Period for such Eurodollar Rate Loan.

"Eurodollar Rate" means for any Interest Period with respect to any Eurodollar Rate Loan:

(a) the rate per annum equal to the rate determined by the Administrative Agent to be the offered rate that appears on the page of the Telerate screen (or any successor thereto) that displays an average British Bankers Association Interest Settlement Rate for deposits in Dollars (for delivery on the first day of such Interest Period) with a term equivalent to such Interest Period, determined as of approximately 11:00 a.m. (London time) three (3) Business Days prior to the first day of such Interest Period, or

(b) if the rate referenced in the preceding subsection (a) does not appear on such page or service or such page or service shall cease to be available, the rate per annum equal to the rate determined by the Administrative Agent to be the offered rate on such other page or other service that displays an average British Bankers Association Interest Settlement Rate for deposits in Dollars (for delivery on the first day of such Interest Period) with a term equivalent to such Interest Period, determined as of approximately 11:00 a.m. (London time) three (3) Business Days prior to the first day of such Interest Period, or

(c) if the rates referenced in the preceding subsections (a) and (b) are not available, the rate per annum determined by the Administrative Agent as the rate of interest (rounded upward to the next 1/100th of 1%) at which deposits in Dollars for delivery on the first day of such Interest Period in same day funds in the approximate amount of the Eurodollar Rate Loan being made, continued or converted by BNP Paribas and with a term equivalent to such Interest Period would be offered by BNP Paribas' London Branch as stated on Telerate News Service Page 3750 as of 11:00 a.m. (London time) three (3) Business Days prior to the first day of such Interest Period. If such interest rates shall cease to be available from Telerate News Service, such interest rates shall be determined from such financial reporting service or other information as shall be mutually acceptable to the Administrative Agent and the Co-Borrowers.

"Eurodollar Rate Loan" means a Loan that bears interest at a rate based on the Eurodollar Rate.

"Event of Default" means any of the events or circumstances specified in Section 9.01.

"Exchange Act" means the Securities and Exchange Act of 1934, as amended, and regulations promulgated thereunder.

"Existing Advances" means all Loans outstanding under the Existing Credit Agreement on the Closing Date.

"Expiration Date" means the earliest to occur of:

(a) July 23, 2004; or

(b) the date an Event of Default occurs.

"Facility Amount" means $110,000,000.00.

"FDIC" means the Federal Deposit Insurance Corporation, and any Governmental Authority succeeding to any of its principal functions.

"Federal Funds Rate" means, for any day, the rate set forth in the weekly statistical release designated as H.15(519), or any successor publication, published by the Federal Reserve Bank of New York (including any such successor, "H.15(519)") on the preceding Business Day opposite the caption "Federal Funds (Effective)"; or, if for any relevant day such rate is not so published on any such preceding Business Day, the rate for such day will be the arithmetic mean as determined by the Administrative Agent of the rates for the last transaction in overnight Federal Funds arranged prior to 9:00 a.m. (New York City time) on that day by each of three leading brokers of Federal Funds transactions in New York City selected by the Administrative Agent.

"Fiscal Quarter" means the quarterly periods ending March 31, June 30, September 30 and December 31.

"Fortis" means Fortis Capital Corp., a Connecticut corporation.

"FRB" means the Board of Governors of the Federal Reserve System, and any Governmental Authority succeeding to any of its principal functions.

"Further Taxes" means any and all present or future taxes, levies, assessments, imposts, duties, deductions, fees, withholding or similar charges (including, without limitation, net income taxes and franchise taxes), and all liabilities with respect thereto, imposed by any jurisdiction on account of amounts payable or paid pursuant to Section 4.01.

"GAAP" means generally accepted accounting principles set forth from time to time in the opinions and pronouncements of the Accounting Principles Board and the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board (or agencies with similar functions of

comparable stature and authority within the U.S. accounting profession), which are applicable to the circumstances as of the date of determination.

"Governmental Authority" means any nation or government, any state or other political subdivision thereof, any central bank (or similar monetary or regulatory authority) thereof, any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government, and any corporation or other entity owned or controlled, through stock or capital ownership or otherwise, by any of the foregoing.

"Guarantors" means each of Avista Capital and Copac Management.

"Guaranty" means a guaranty agreement in form and substance acceptable to Administrative Agent and the Banks, which has been executed by a Guarantor and delivered to Administrative Agent for the benefit of the Banks.

"Guaranty Obligation" has the meaning specified in the definition of "Contingent Obligation."

"Honor Date" has the meaning specified in Subsection 3.03(b).

"Indebtedness" of any Person means, without duplication, (a) all indebtedness for borrowed money; (b) all obligations issued, undertaken or assumed as the deferred purchase price of property or services (other than trade payables entered into in the ordinary course of business on ordinary terms); (c) all non-contingent reimbursement or payment obligations with respect to Surety Instruments; (d) all obligations evidenced by notes, bonds, debentures or similar instruments, including obligations so evidenced incurred in connection with the acquisition of property, assets or businesses; (e) all indebtedness created or arising under any conditional sale or other title retention agreement, or incurred as financing, in either case with respect to property acquired by the Person (even though the rights and remedies of the seller or bank under such agreement in the event of default are limited to repossession or sale of such property); (f) all obligations with respect to capital leases; (g) all obligations with respect to swap contracts; (h) all indebtedness referred to in clauses (a) through (g) above secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien upon or in property (including accounts and contract rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such indebtedness; and (i) all Guaranty Obligations in respect of indebtedness or obligations of others of the kinds referred to in clauses (a) through (g) above.

"Indemnified Liabilities" has the meaning specified in Section 11.05.

"Indemnified Person" has the meaning specified in Section 11.05.

"Independent Auditor" has the meaning specified in Subsection 7.01(a).

"Insolvency Proceeding" means, with respect to any Person (a) any case, action or proceeding with respect to such Person before any court or other Governmental Authority relating to bankruptcy, reorganization, insolvency, liquidation, receivership, dissolution, winding-up or relief of debtors, or (b) any general assignment for the benefit of creditors, composition, marshalling of assets for creditors, or other, similar arrangement in respect of its creditors generally or any substantial portion of its creditors; undertaken under U.S. Federal, state or foreign law, including the Bankruptcy Code.

"Interest Payment Date" means, as to any Loan other than a Base Rate Loan, the last day of each Interest Period applicable to such Loan and, as to any Base Rate Loan, the fifth Business Day of each month.

"Interest Period" means, as to any Eurodollar Rate Loan, the period commencing on the Borrowing Date of such Loan or on the Conversion/Continuation Date on which the Loan is converted into or continued as an Eurodollar Rate Loan, and ending on the date one, two or three months thereafter selected by the Co-Borrowers as the ending date thereof in its Notice of Borrowing or Notice of Conversion/Continuation;

provided that:

(a) if any Interest Period would otherwise end on a day that is not a Business Day, that Interest Period shall be extended to the following Business Day unless the result of such extension would be to carry such Interest Period into another calendar month, in which event such Interest Period shall end on the preceding Business Day;

(b) any Interest Period pertaining to an Eurodollar Rate Loan that begins on the last Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such Interest Period) shall end on the last Business Day of the calendar month at the end of such Interest Period; and

(c) no Interest Period shall extend beyond the Expiration Date.

"IRS" means the Internal Revenue Service, and any Governmental Authority succeeding to any of its principal functions under the Code.

"Issue" means, with respect to any Letter of Credit, to issue or to extend the expiry of, or to renew or increase the amount of, such Letter of Credit; and the terms "Issued," "Issuing" and "Issuance" have corresponding meanings.

"Issuing Bank" means BNP Paribas and Fortis, and in the future means any Bank which Issues Letters of Credit hereunder, in such Bank's capacity as an issuer of one or more Letters of Credit hereunder.

"L/C Advance" means each Bank's participation in any L/C Borrowing in accordance with its Pro Rata Share.

"L/C Amendment Application" means an application form for amendment of outstanding standby or commercial documentary letters of credit as shall at any time be in use at Issuing Bank, as Issuing Bank shall request.

"L/C Application" means an application form for Issuances of standby or commercial documentary letters of credit as shall at any time be in use at Issuing Bank, as Issuing Bank shall request. Each L/C Application requesting the Issuance of a Letter of Credit to support the trading of Product shall include a certification that the Co-Borrowers are in compliance with the applicable sub-limit for such type of letter of credit.

"L/C Borrowing" means an extension of credit resulting from either a drawing under any Letter of Credit or a Reducing L/C Borrowing, which extension of credit shall not have been reimbursed on the date when made nor converted into a Borrowing of Dollar Advances under Section 3.03.

"L/C Cap" means the maximum availability for Issuance of Letters of Credit under the Borrowing Base Line which shall be an amount equal to the Borrowing Base Cap less the Effective Amount of the outstanding Revolving Loans.

"L/C Obligations" means at any time the sum of (a) the aggregate undrawn amount of all Letters of Credit then outstanding, plus (b) the amount of all unreimbursed drawings under all Letters of Credit, including all outstanding L/C Borrowings.

"L/C-Related Documents" means the Letters of Credit, the L/C Applications, the L/C Amendment Applications and any other document relating to any Letter of Credit, including, but not limited to, any of Issuing Bank's standard form documents for letter of credit issuances.

"L/C Sub-limit" means the limits upon L/C Obligations for each of the Co-Borrowers under particular types of Letters of Credit Issued under the Credit Lines as set forth on Schedule 2.01. Subject to the individual sub-limits referenced in Schedule 2.01, any Letter of Credit may be issued in Canadian Dollars, provided that the aggregate amount of all Letters of Credit issued under the Credit Lines in Canadian Dollars shall not exceed Canadian Dollar Equivalent of U.S. $30,000,000.00.

"Lending Office" means, as to any Bank, the office or offices of such Bank specified as its "Lending Office" on Schedule 11.02, or such other office or offices as such Bank may from time to time notify the Co-Borrowers and the Administrative Agent.

"Letters of Credit" means (a) any letters of credit (whether standby letters of credit or commercial documentary letters of credit) Issued by Issuing Bank pursuant to Article III, and (b) any Reducing Letters of Credit.

"Lien" means any security interest, mortgage, deed of trust, pledge, hypothecation, assignment, charge, encumbrance, or lien, statutory or other in respect of any property, including those created by, arising under or evidenced by any conditional sale or other title retention agreement, the interest of a lessor under a capital lease, any financing lease having substantially the same economic effect as any of the foregoing, or the filing of any financing statement naming the owner of the asset to which such lien relates as debtor, under the Uniform Commercial Code or any comparable law.

"Line Portion" means for each Bank the portion of the Credit Lines assigned to such Bank as set forth on Schedule 2.01.

"Loan" means any extension of credit by a Bank to the Co-Borrowers under Article II or Article III in the form of (a) a Revolving Loan or (b) an L/C Advance.

"Loan Documents" means this Agreement, the Notes, the Guaranties, the Security Agreements, the Override Agreement, the L/C-Related Documents, Swap Contracts, and all other documents delivered to the Administrative Agent or any Bank or Affiliate of any Bank in connection herewith or delivered to BNP Paribas or any of its affiliates in connection with Daylight Overdrafts.

"Loan Parties" means each of the Co-Borrowers and the Guarantors.

"Lockbox" means the lockbox associated with the Bank Blocked Accounts maintained by Avista Canada into which all checks and similar items sent by Account Debtors of Avista Canada are to be received.

"Margin Stock" means "margin stock" as such term is defined in Regulation T, U or X of the FRB.

"Mark-to-Market" means the method of accounting used to account for derivative commodity instruments entered into for trading purposes, on an Economic Basis.

"Marketable Securities" means (a) certificates of deposit issued by Wells Fargo or BNP Paribas or by any other bank, with a Fitch rating of A or better, (b) commercial paper rated P-1, A-1 or F-1, excluding that issued by Avista Corporation, (c) bankers acceptances rated Prime, or (d) U.S. Government obligations, in each case with tenors of 360 days or less.

"Material Adverse Effect" means (a) a material adverse change in, or a material adverse effect upon, the operations, business, properties, condition (financial or otherwise) or prospects of either a Loan Party or a Loan Party and its Subsidiaries taken as a whole; (b) a material impairment of the ability of any Loan Party to perform its obligations under any Loan Document to which it is a party; (c) a material adverse effect upon the legality, validity, binding effect or enforceability against any Loan Party of any Loan Document to which it is a party or (d) any Loan Party at any time asserts that any

Loan Document is not legal or valid, or is not binding upon or enforceable against such Loan Party.

"Maturity Date" means July 23, 2006.

"Multiemployer Plan" means a "multiemployer plan," within the meaning of Section 4001(a)(3) of ERISA, to which a Co-Borrower or any ERISA Affiliate makes, is making, or is obligated to make contributions or, during the preceding three (3) calendar years, has made, or been obligated to make, contributions.

"Natexis" means Natexis Banques Populaires, a bank organized under the laws of France.

"Net Working Capital" means net working capital as calculated on an Economic Basis, less cash securing Letters of Credit issued under the Collateralized L/C Line, less cash held in the Wells Fargo Collateral Account to secure Avista's obligations under the Wells Fargo FX Documents, less amounts due from Affiliates (including any loans to Avista Capital), less California Receivables plus Eligible Subordinated Debt that is classified as a current liability.

"Net Worth" means net worth as calculated on an Economic Basis, less amounts due from employees and Affiliates (provided however that any loans to Avista Capital or Avista Corporation debt securities purchased by the Co-Borrowers shall not be deducted), less the amount of California Receivables and less intangible assets of the Co-Borrowers, plus Eligible Subordinated Debt.

"Notes" means the promissory notes executed by the Co-Borrowers in favor of a Bank pursuant to Subsection 2.02(b), in form approved by the Banks. Notes will be issued by the Co-Borrowers to each entity that becomes a Bank hereunder from time to time, but will not be issued to Participants of a Bank.

"Notice of Borrowing" means the applicable notice in substantially the form of Exhibit A.

"Notice of Conversion/Continuation" means a notice in substantially the form of Exhibit B.

"Obligations" means all advances, debts, liabilities, obligations, covenants and duties arising under any Loan Document owing by a Co-Borrower to any Bank, or any affiliate of any Bank, the Administrative Agent, or any Indemnified Person, including without limitation, Revolving Loans, Daylight Overdrafts, Overdraft Advances, L/C Obligations and obligations arising under Swap Contracts (including foreign exchange contracts), and whether direct or indirect (including those acquired by assignment), absolute or contingent, due or to become due, now existing or hereafter arising.

"Operating Accounts" means (i) account maintained by Avista with Wells Fargo, (ii) account maintained by Avista with Wells Fargo, (iii) multicurrency account maintained by Avista with Wells Fargo, and (iv) multicurrency account maintained by Avista Canada with Wells Fargo, into which funds may be transferred pursuant to Section 7.15.

"Organization Documents" means (a) for any corporation, the certificate or articles of incorporation, the bylaws, any certificate of determination or instrument relating to the rights of preferred shareholders of such corporation, any shareholder rights agreement, and all applicable resolutions of the board of directors (or any committee thereof) of such corporation, and (b) for any partnership, the partnership agreement, and all other documents or filings as may be required by the Secretary of State (or other applicable governmental agency) in the state of such partnership's formation.

"Other Taxes" means any present or future stamp or documentary taxes or any other excise or property taxes, charges or similar levies which arise from any payment made hereunder or from the execution, delivery or registration of, or otherwise with respect to, this Agreement or any other Loan Documents.

"Out-of-the-Money Positions" means the Co-Borrowers' net out-of-the-money forward positions with counter parties whose Eligible Accounts, Eligible Exchange Receivables and Unbilled Eligible Accounts are included in calculations of the Borrowing Base Cap.

"Overdraft Advance" means any advance made hereunder by the Banks to BNP Paribas pursuant to Subsection 2.01(c) hereof under the Overdraft Advance Sub-limit.

"Overdraft Advance Sub-limit" means that certain Overdraft Advance Sub-limit under the Borrowing Base Line set forth in Schedule 2.01.

"Override Agreement" means that Override and Control Agreement dated as of July 25, 2003, by and among Avista, Avista Capital, BNP Paribas as Collateral Agent and Wells Fargo.

"Paribas Investment Accounts" means (i) Account , Account , Account and Account , together with any subaccounts relating thereto, maintained by Avista with BNP Paribas, and any additional account established by either of the Co-Borrowers with BNP Paribas, or (ii) any account established by either of the Co-Borrowers with BNP Paribas in substitution for or in addition to such accounts listed in (i), into which funds may be transferred from a Bank Blocked Account pursuant to Sections 7.15 and 11.12 below.

"Participant" has the meaning specified in Subsection 11.08(d).

"PBGC" means the Pension Benefit Guaranty Corporation, or any Governmental Authority succeeding to any of its principal functions under ERISA.

"Performance L/C" means any and all standby Letters of Credit other than Trade Related L/Cs and Swap L/Cs.

"Permitted Liens" has the meaning specified in Section 8.01.

"Person" means an individual, partnership, corporation, business trust, joint stock company, trust, unincorporated association, joint venture or Governmental Authority.

"Plan" means a pension plan (as defined in Section 3(2) of ERISA) subject to Title IV of ERISA which a Co-Borrower sponsors, maintains, or to which it makes, is making, or is obligated to make contributions, or in the case of a multiple employer plan (as described in Section 4064(a) of ERISA) has made contributions at any time during the immediately preceding five (5) plan years.

"Posted Collateral" means all posted collateral or cash margin received from counterparties.

"Product" means natural gas and electricity.

"Pro Rata Share" means, as to any Bank at any time, the percentage equivalent (expressed as a decimal, rounded to the ninth decimal place) at such time of such Bank's Line Portion of the Borrowing Base Line and the Collateralized L/C Line, as the case may be, divided by the aggregate amount of such lines.

"RBC" means Royal Bank of Canada.

"Reducing Letters of Credit" means any standby letters of credit that (a) are Issued by an Issuing Bank pursuant to Article III, and (b) specifically provide that the amount available for drawing under such letters of credit will be reduced, automatically and without any further amendment or endorsement to such letters of credit, by the amount of any payment or payments made to the beneficiary of such letter of credit by the Co-Borrowers if such payment or payments (i) are made through such Issuing Bank and (ii) reference such letters of credit by the letter of credit numbers thereof, notwithstanding the fact that such payment or payments are not made pursuant to conforming and proper draws under such letters of credit.

"Reducing L/C Borrowing" means any extension of credit by the Banks to the Co-Borrowers for the purpose of funding any payment or payments made to the beneficiary of a Reducing Letter of Credit by the Co-Borrowers if such payment or payments (a) are made through the Issuing Bank of such Reducing Letter of Credit, (b) reference the Reducing Letter of Credit by the letter of credit number thereof, and (c) are

not made pursuant to a conforming and proper draw under such Reducing Letter of Credit.

“Replacement Bank” has the meaning specified in Section 4.08.

“Reportable Event” means, any of the events set forth in Section 4043(b) of ERISA or the regulations thereunder, other than any such event for which the 30-day notice requirement under ERISA has been waived in regulations issued by the PBGC.

“Required Banks” means Banks holding two thirds of all the Line Portions.

“Requirement of Law” means, as to any Person, any law (statutory or common), treaty, rule or regulation or determination of an arbitrator or of a Governmental Authority, in each case applicable to or binding upon the Person or any of its property or to which the Person or any of its property is subject.

“Responsible Officer” means, for either Co-Borrower, any one of the Chairman of the Board, President, any Vice President or the Controller of such Co-Borrower.

“Revolving Loan” has the meaning specified in Section 2.01.

“Security Agreements” means security agreements, in form and substance acceptable to Administrative Agent and the Banks, duly executed by each of the Co-Borrowers and delivered to Administrative Agent granting to the Collateral Agent for the benefit of the Banks, a first and prior security interest in and Lien upon the Collateral.

“Subordinated Debt” means Indebtedness of the Co-Borrowers which has been reported to the Banks and which has been subordinated to the Obligations in form and content acceptable to the Banks in their sole discretion.

“Subsidiary” of a Person means any corporation, association, partnership, joint venture or other business entity of which more than 50% of the voting stock or other equity interests (in the case of Persons other than corporations), is owned or controlled directly or indirectly by the Person, or one or more of the Subsidiaries of the Person, or a combination thereof. Unless the context otherwise clearly requires, references herein to a “Subsidiary” refer to a Subsidiary of the Co-Borrowers.

“Surety Instruments” means all letters of credit (including standby and commercial), banker’s acceptances, bank guaranties, shipside bonds, surety bonds and similar instruments.

“Swap Banks” means BNP Paribas and its Affiliates in their capacity as a party to a Swap Contract.

“Swap Contract” means any agreement entered into with any Swap Bank or any Affiliate of any Swap Bank, whether or not in writing, relating to any single transaction

that is a rate swap, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap or option, bond, note or bill option, interest rate option, forward foreign exchange transaction, cap, collar or floor transaction, currency swap, cross-currency rate swap, currency option or any other similar transaction (including any option to enter into any of the foregoing) or any combination of the foregoing and, unless the context clearly requires, any master agreement relating to or governing any or all of the foregoing.

"Swap L/Cs" means standby Letters of Credit Issued to support payments owed to counterparties under Swap Contracts with a tenor of 364 days or less, or 2 years or less if issued under the Collateralized L/C Line.

"Taxes" means any and all present or future taxes, levies, assessments, imposts, duties, deductions, fees, withholdings, or similar charges, and all liabilities with respect thereto, excluding, in the case of each Bank and the Administrative Agent, taxes imposed on or measured by each Bank's net income or capital (with respect to franchise taxes or similar taxes) by the jurisdiction (or any political subdivision thereof) under the laws of which such Bank or the Administrative Agent, as the case may be, is organized or maintains a lending office.

"Trade Related L/C" means any and all standby and Documentary Letters of Credit Issued in support of the purchase of Product by the Co-Borrowers.

"Type" means either a Base Rate Loan or a Eurodollar Rate Loan.

"Unbilled Eligible Accounts" means Accounts of the Co-Borrowers for Product which has been delivered to an Account Debtor and which would be Eligible Accounts but for the fact that such Accounts have not actually been invoiced at such time, based upon the value of the underlying sales contract.

"Undelivered Product Value" means the lesser of the (a) cost or (b) current market value of Product (as referenced by a published source acceptable to all the Banks in their sole discretion) purchased by a Co-Borrower under the Letters of Credit which has not been physically delivered to such Co-Borrower. Undelivered Product Value cannot simultaneously be included in an Eligible Exchange Receivable, and in no event shall the value of any Letter of Credit Issued in favor of a pipeline company for transportation services or a Letter of Credit Issued to support payments owed to counterparties under swap contracts be included in this definition.

"United States" and "U.S." each means the United States of America.

"Value at Risk of Open Positions" the Dollar value of Co-Borrowers' 3-day risk of loss from open positions in Product, as determined by Co-Borrowers' utilization of the Co-Borrowers' proprietary software program or any other appropriate software program, with the prior written approval of the Banks.

“Value at Risk Report” means a certificate of the Co-Borrowers in form attached hereto as Exhibit F together with attached reports which detail the Co-Borrowers’ open positions in Product and the Value at Risk of such Open Positions, such reports to be acceptable to the Banks as to form and substance.

“Wells Fargo” means Wells Fargo Bank National Association.

“Wells Fargo Accounts” means the Bank Block Accounts, the Operating Accounts, and the Wells Fargo Investment Accounts, all of which are maintained at Wells Fargo pursuant to the Wells Fargo Account Documentation.

“Wells Fargo Account Documentation” means the Override Agreement, the Restricted Account and Securities Account Control Agreement, the Investment Management Agreements and related Custody Agreements (in the form of any Addendum thereto), the Four Party Lockbox and Restricted Account Agreement, the Restricted Account Agreement executed by Avista, the Restricted Account Agreement executed by Avista Canada, the Royal Bank of Canada Receivable Payment Service – Automated Lockbox Client Questionnaire and Canadian Lockbox Service Description, the Master Agreement for Treasury Management Services and any addendum or notice thereto, the Wire Transfer Services Security Procedure Agreement and any addendum thereto and Wire Transfer Service Description, the Commercial Checking Account Authorization and Agreement (Signature Card), the W-9 and Overland Sweep Service Description, the Commercial Electronic Office Online Access Agreement and WellsNet Service Description, the Royal Bank of Canada Checking Account Signature Cards and Canadian Dollar Checking Account Service Description, the Canadian Checking Account Royal Bank of Canada New Account Opening Questionnaire, the Wells Fargo Bank, N.A. Multi-Currency Account Authorization and Agreement (Signature Card) and Multi-Currency Account Service Description, the Foreign Exchange Online Agreement, corporate resolutions, and any other or additional documents, agreements or instruments related thereto which shall be reasonably acceptable to the Administrative Agent.”

“Wells Fargo Collateral Account” means Account maintained by Avista at Wells Fargo to secure its obligations under Wells Fargo FX Documents.

“Wells Fargo FX Documents” means (i) the Foreign Exchange Agreement with Avista dated October 31, 2002, (ii) the Security Agreement: Rights to Payment with Avista dated October 31, 2002, and (iii) the Account Control Agreement with Avista and BNP Paribas dated October 31, 2002.

“Wells Fargo Investment Accounts” means (i) that certain Overland Mutual Fund securities Account maintained with Wells Fargo, and (ii) Account maintained with Wells Fargo.

1.02 Other Interpretive Provisions.

(a) The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(b) The words “hereof,” “herein,” “hereunder” and similar words refer to this Agreement as a whole and not to any particular provision of this Agreement; and Subsection, Section, Schedule and Exhibit references are to this Agreement unless otherwise specified.

(c) (i) The term “documents” includes any and all instruments, documents, agreements, certificates, indentures, notices and other writings, however evidenced.

(ii) The term “including” is not limiting and means “including without limitation.”

(iii) In the computation of periods of time from a specified date to a later specified date, the word “from” means “from and including,” the words “to” and “until” each mean “to but excluding,” and the word “through” means “to and including.”

(d) Unless otherwise expressly provided herein, (i) references to agreements (including this Agreement) and other contractual instruments shall be deemed to include all subsequent amendments and other modifications thereto, but only to the extent such amendments and other modifications are not prohibited by the terms of any Loan Document, and (ii) references to any statute or regulation are to be construed as including all statutory and regulatory provisions consolidating, amending, replacing, supplementing or interpreting the statute or regulation.

(e) The captions and headings of this Agreement are for convenience of reference only and shall not affect the interpretation of this Agreement.

(f) This Agreement and other Loan Documents may use several different limitations, tests or measurements to regulate the same or similar matters. All such limitations, tests and measurements are cumulative and shall each be performed in accordance with their terms.

(g) This Agreement and the other Loan Documents are the result of negotiations among and have been reviewed by counsel to the Administrative Agent, the Banks, the Co-Borrowers and the other parties, and are the products of all parties. Accordingly, they shall not be construed against the Banks or the Administrative Agent merely because of the Administrative Agent’s or Banks’ involvement in their preparation.

1.03 Accounting Principles.

(a) Unless the context otherwise clearly requires, all accounting terms not expressly defined herein shall be construed, and all financial computations required under this Agreement shall be made in accordance with GAAP, consistently applied.

(b) References herein to “fiscal year” refer to such fiscal years of the Co-Borrowers.

ARTICLE II

THE CREDITS

2.01 Amounts and Terms of Borrowing Base Line.

(a) Revolving Loans. Each Bank severally agrees, on the terms and conditions set forth herein, to make Loans, from time to time, to the Co-Borrowers under the Borrowing Base Line (each such loan, a “Revolving Loan”) on any Business Day during the period from the Closing Date to the Expiration Date, in an aggregate amount not to exceed at any time outstanding the lesser of (i) such Bank’s Line Portion; or (ii) such Bank’s Co-Borrower Sub-limit Portion for any Co-Borrower; provided, however, that, after giving effect to any Borrowing of Revolving Loans, the Effective Amount of all outstanding Revolving Loans, plus the Effective Amount of all L/C Obligations under the Borrowing Base Line, shall not exceed the Borrowing Base Cap, and at no time shall any Revolving Loan exceed the applicable Co-Borrowers’ Sub-limit under the Borrowing Base Line. A Revolving Loan may take the form of (i) a Dollar Advance, (ii) an Overdraft Advance, or (iii) in the case of BNP Paribas, a Daylight Overdraft.

(b) Daylight Overdrafts. BNP Paribas has agreed to consider, on a discretionary basis, making Daylight Overdrafts, from time-to-time, for the benefit of the Co-Borrowers; provided, however, that, the sum of the requested Daylight Overdrafts, plus the Effective Amount of all other outstanding Revolving Loans, plus the Effective Amount of all L/C Obligations then existing under the Borrowing Base Line shall not exceed the Borrowing Base Cap.

(c) Overdraft Advances and Swap Contracts.

(i) In the event that either (1) any amounts owing to BNP Paribas for Daylight Overdrafts or to a Swap Bank or any of its Affiliates under any Swap Contract are not paid within two (2) Business Days after such obligation arises; or (2) BNP Paribas has made a Daylight Overdraft in the amount of a drawing under a Letter of Credit which has not been timely reimbursed by the Co-Borrowers in accordance with Subsection 3.03(b) of this Agreement and such amount has not been paid by the Co-Borrowers within one (1) Business Day after such obligation arises, then BNP Paribas or a Swap Bank (as the case may be) shall notify the Administrative Agent of such failure to pay and except as set forth below the Administrative Agent (without the necessity of any

instructions or request from the Co-Borrowers) shall make an Overdraft Advance in accordance with the provisions of Section 2.03 of this Agreement under the Borrowing Base Line for any amounts due by the Co-Borrowers to BNP Paribas to reimburse it for such Daylight Overdrafts or a Dollar Advance to such Swap Bank or any of its Affiliates under any Swap Contract, and then apply the proceeds of such advance to pay to BNP Paribas all amounts owed to BNP Paribas for Daylight Overdrafts or to a Swap Bank or any of its Affiliates under such Swap Contract.

(ii) Upon making any such Overdraft Advance, the Administrative Agent shall send notice of such Overdraft Advance to the Co-Borrowers and the Banks (who shall promptly disburse to Administrative Agent each Bank's Pro Rata Share of such Overdraft Advance), and such Overdraft Advance shall constitute a Revolving Loan which shall initially be a Base Rate Loan.

(iii) Except for advances made to reimburse BNP Paribas for Daylight Overdrafts made to fund drawings under Letters of Credit or to fund Reducing L/C Borrowings, the principal of any advance made (1) to repay BNP Paribas for Daylight Overdrafts or (2) to pay to any Swap Bank or its Affiliates any obligation due under a Swap Contract shall not cause the sum of the Effective Amounts of all other outstanding Revolving Loans, plus L/C Obligations under the Borrowing Base Line to exceed the Borrowing Base Cap.

(iv) The Co-Borrowers, however, shall pay the amount of any such excess above the proceeds of the Revolving Loan to BNP Paribas or the Swap Bank, as the case may be, together with interest thereon, within one (1) Business Day after the date such Revolving Loan is made. Unless the Co-Borrowers timely pay such excess amount to BNP Paribas or such Swap Bank, as the case may be, the Pro Rata Share of such Bank shall be adjusted to account for such excess amount as is set forth in the definition of Adjusted Pro Rata Share. If, however, a Revolving Loan is made to reimburse BNP Paribas for Daylight Overdrafts made to fund drawings under Letters of Credit or to fund Reducing L/C Borrowings, the principal amount of such Revolving Loan may exceed the availability under the Borrowing Base Cap, and all Banks shall have the duty to fund their Pro Rata Share of such Revolving Loan, including the excess above the availability under the Borrowing Base Cap. In the event such Revolving Loan does cause the sum of the Effective Amounts of all outstanding Revolving Loans, plus L/C Obligations under the Borrowing Base Line to exceed the Borrowing Base Cap, the Co-Borrowers shall pay to Administrative Agent, for the benefit of the Banks, the amount of such excess, together with interest thereon, within one (1) Business Day after the date when such Revolving Loan is made.

(v) In all instances, Co-Borrowers agree not to use a Daylight Overdraft to pay a prior Daylight Overdraft, but BNP Paribas shall have no duty to the Banks to monitor such activity.

(d) Overall Limitation. Outstanding Daylight Overdrafts (which have not been paid by the Co-Borrowers or through Overdraft Advances), plus the Effective Amount of

all other outstanding Revolving Loans, plus the Effective Amount of all L/C Obligations under the Borrowing Base Line shall not at any time exceed the Borrowing Base Cap.

(e) Termination. Notwithstanding the foregoing, BNP Paribas in its sole discretion at any time may, and upon two (2) Business Days advance notice received from the Required Banks shall, terminate its obligation to consider making Daylight Overdrafts. The delivery of a notice to terminate the making of Daylight Overdrafts may be given by the Required Banks at any time in their sole discretion, and the Required Banks shall copy the Co-Borrowers on the notice given to BNP Paribas.

2.02 Loan Accounts.

(a) The Loans made by each Bank and the Letters of Credit Issued by an Issuing Bank shall be evidenced by one or more accounts or records maintained by Administrative Agent in the ordinary course of business. As of the date hereof, the Existing Advances shall be deemed to be Loans made hereunder and shall be entitled to all benefits of the Loan Documents and secured by the Security Agreement. On the date hereof, the Company shall pay all accrued interest on the Existing Advances. The accounts or records maintained by the Administrative Agent shall be conclusive absent manifest error of the amount of the Loans made by the Banks to the Co-Borrowers and the Letters of Credit Issued for the account of the Co-Borrowers hereunder, and the interest and payments thereon. Any failure so to record or any error in doing so shall not, however, limit or otherwise affect the Obligation of the Co-Borrowers hereunder to pay any amount owing with respect to the Loans or any Letter of Credit.

(b) Upon the request of any Bank made through the Administrative Agent, the Loans made by such Bank may be evidenced by one or more Notes, instead of loan accounts. Each such Bank may endorse on the schedules annexed to its Note(s) the date, amount and maturity of each Loan made by it and the amount of each payment of principal made by the Co-Borrowers with respect thereto. Each such Bank is irrevocably authorized by the Co-Borrowers to endorse its Note(s) and each Bank's record shall be conclusive absent manifest error; provided, however, that the failure of a Bank to make, or an error in making, a notation thereon with respect to any Loan shall not limit or otherwise affect the Obligations of the Co-Borrowers hereunder or under any such Note to such Bank.

2.03 Procedure for Borrowing.

(a) Each Borrowing of Revolving Loans consisting only of Base Rate Loans shall be made upon a Co-Borrower's irrevocable written notice delivered to the Administrative Agent in the form of a Notice of Borrowing (Revolving Loan), which notice must be received by the Administrative Agent prior to 1:00 p.m. (New York City time) on the Borrowing Date specifying the amount of the Borrowing and the duration of the Interest Period. Each such Notice of Borrowing shall be by electronic transfer or facsimile, confirmed immediately in an original writing. Each Borrowing of Revolving Loans that includes any Eurodollar Rate Loans shall be made upon a Co-Borrower's irrevocable written notice delivered to the Administrative Agent in the form of a Notice of Borrowing (which notice must be received by the Administrative Agent prior to 1:00 p.m. (New York City time) three (3) Business Days prior to the requested

Borrowing Date), specifying the amount of the Borrowing and the duration of the Interest Period. Each such Notice of Borrowing shall be by electronic transfer or facsimile, confirmed immediately in an original writing. Each requested Eurodollar Rate Loan must have an Eurodollar Effective Amount of at least $15,000,000.00.

(b) The Administrative Agent will promptly notify each Bank of its receipt of any Notice of Borrowing and of the amount of such Bank's Pro Rata Share of that Borrowing and the duration of the Interest Period.

(c) If the Administrative Agent elects in its sole discretion to advance a Loan pursuant to a Notice of Borrowing, each Bank will be deemed to have approved such Borrowing and will make the amount of its Pro Rata Share of such Borrowing available to the Administrative Agent for the account of the Co-Borrowers at the Administrative Agent's Payment Office by 3:00 p.m. (New York City time) on the Borrowing Date requested by the Co-Borrowers in funds immediately available to the Administrative Agent. The proceeds of all such Loans will then be made available to the Co-Borrowers by the Administrative Agent at such office by crediting the account of the Co-Borrowers on the books of Administrative Agent with the aggregate of the amounts made available to the Administrative Agent by the Banks and in like funds as received by the Administrative Agent.

(d) A Daylight Overdraft may be made by BNP Paribas in its sole discretion upon written request from a Co-Borrower unless BNP Paribas has received a notice from the Required Banks pursuant to Subsection 2.01(d) to terminate making Daylight Overdrafts.

2.04 Conversion and Continuation Elections.

(a) A Co-Borrower may, upon irrevocable written notice to the Administrative Agent in accordance with Subsection 2.04(b):

(i) elect, as of any Business Day, in the case of Base Rate Loans, or as of the last day of the applicable Interest Period, in the case of any Eurodollar Rate Loan, to convert any such Loans into Loans of any other Type (provided, however, the Eurodollar Effective Amount of each Eurodollar Rate Loan must be at least $15,000,000.00); or

(ii) elect as of the last day of the applicable Interest Period, to continue any Revolving Loans having Interest Periods expiring on such day (provided, however, the Eurodollar Effective Amount of each Eurodollar Rate Loan must be at least $15,000,000.00);

provided, that if at any time the aggregate amount of Eurodollar Rate Loans in respect of any Borrowing is reduced, by payment, prepayment, or conversion of part thereof, to have an Eurodollar Effective Amount of less than $15,000,000.00, such Eurodollar Rate Loans shall automatically convert into Base Rate Loans, and on and after such date the right of such Co-Borrower to continue such Loans as, and convert such Loans into, Eurodollar Rate Loans shall terminate.

(b) A Co-Borrower shall deliver a Notice of Conversion/Continuation to be received by the Administrative Agent not later than 1:00 p.m. (New York City time) on the Conversion/Continuation Date if the Loans are to be converted into Base Rate Loans; and three (3) Business Days in advance of the Conversion/Continuation Date, if the Loans are to be converted into or continued as Eurodollar Rate Loans, specifying:

(i) the proposed Conversion/Continuation Date;

(ii) the aggregate amount of Loans to be converted or continued;

(iii) the Type of Loans resulting from the proposed conversion or continuation; and

(iv) other than in the case of conversions into Base Rate Loans, the duration of the requested Interest Period.

(c) If upon the expiration of any Interest Period applicable to Eurodollar Rate Loans, a Co-Borrower has failed to timely select a new Interest Period to be applicable to its Eurodollar Rate Loans, or if any Default or Event of Default then exists, such Co-Borrower shall be deemed to have elected to convert such Eurodollar Rate Loans into Base Rate Loans effective as of the expiration date of such Interest Period.

(d) The Administrative Agent will promptly notify each Bank of its receipt and the contents of a Notice of Conversion/Continuation, or, if no timely notice is provided by a Co-Borrower, the Administrative Agent will promptly notify each Bank of the details of any automatic conversion. All conversions and continuations shall be made ratably according to the respective outstanding principal amounts of the Loans, with respect to which the notice was given, held by each Bank.

(e) Unless the Banks otherwise agree, during the existence of a Default or Event of Default, the Co-Borrowers may not elect to have a Loan converted into or continued as an Eurodollar Rate Loan.

(f) After giving effect to any Borrowing, conversion or continuation of Loans, there may not be more than seven (7) Interest Periods in effect.

(g) The Administrative Agent will promptly notify, in writing, each Bank of the amount of such Bank’s Pro Rata Share of that Borrowing.

2.05 Optional Prepayments. The Co-Borrowers may, at any time or from time to time, upon the Co-Borrowers’ irrevocable written notice to Administrative Agent received prior to 1:00 p.m. (New York City time) on the date of prepayment, prepay Loans and L/C Obligations in whole or in part. The Administrative Agent will promptly notify each Bank of its receipt of any such prepayment, and of such Bank’s Pro Rata Share of such prepayment.

2.06 Mandatory Prepayments of Loans; Mandatory Commitment Reductions.

(a) If on any date the Effective Amount of L/C Obligations under the Borrowing Base Line exceeds the L/C Cap or any L/C Sub-limit, the Co-Borrowers shall Cash Collateralize on such date the outstanding Letters of Credit in an amount equal to the excess above any such cap or limit, and on the Expiration Date Co-Borrowers shall Cash Collateralize all then outstanding Letters of Credit under the Borrowing Base Line in an amount equal to the Effective Amount of all L/C Obligations related to such Letters of Credit. If on any date after giving effect to any Cash Collateralization made on such date pursuant to the preceding sentence, the Effective Amount of all Revolving Loans then outstanding plus the Effective Amount of all L/C Obligations under the Borrowing Base Line exceeds the Borrowing Base Cap, the Co-Borrowers shall immediately, and without notice or demand, prepay the outstanding principal amount of the Revolving Loans and L/C Advances by an amount equal to the applicable excess.

(b) If pursuant to the definition of "Elected Line Cap," such Elected Line Cap is reduced to a level (including zero) which is less than the amounts outstanding under the Borrowing Base Line, then the Co-Borrowers shall immediately, and without notice or demand, prepay the amount of such excess and Cash Collateralize any outstanding Letters of Credit under the Borrowing Base Line.

2.07 Repayment. The Co-Borrowers shall repay the principal amount of each Revolving Loan to the Administrative Agent on behalf of the Banks, on the Advance Maturity Date for such Loan. The Co-Borrowers shall repay to BNP Paribas the amount of each Daylight Overdraft on the next Business Day after such Daylight Overdraft is made. Notwithstanding anything to the contrary contained herein, except as may be provided in Section 2.13, and Section 2.14, the Banks shall not share in any repayment made with respect to the Daylight Overdrafts unless an Overdraft Advance has been made with respect to such Daylight Overdraft in which case the Banks will share in such repayment by the Co-Borrowers according to their Pro Rata Shares.

2.08 Interest.

(a) Each Revolving Loan (except for a Revolving Loan made to pay a drawing under a Letter of Credit or a Reducing L/C Borrowing) shall bear interest on the outstanding principal amount thereof from the applicable Borrowing Date at a floating rate per annum equal to the Base Rate plus the Applicable Margin at all times such Loan is a Base Rate Loan or at the Eurodollar Rate plus the Applicable Margin at all times such Loan is an Eurodollar Rate Loan. Each Revolving Loan made as a result of a drawing under a Letter of Credit or a Reducing L/C Borrowing, and all amounts owing to the Banks on account of an Overdraft Advance and all amounts owing to a Swap Bank or any Affiliate of a Swap Bank with respect to any Swap Contract, shall bear interest on the outstanding principal amount thereof from the date funded at a floating rate per annum equal to the Base Rate plus the Applicable Margin until such Loan has been outstanding for more than two (2) Business Days and, thereafter, shall bear interest on the outstanding principal amount thereof at a floating rate per annum equal to the Base Rate or the Eurodollar Rate, as the case may be with respect to such

Loan, plus the Applicable Margin, plus three percent (3.0%) per annum (the "Default Rate"). Each Daylight Overdraft shall, until such time as it has been reimbursed by the Co-Borrowers or funded through an Overdraft Advance, bear interest at a rate to be agreed upon by the Co-Borrowers and Paribas.

(b) Interest on each Revolving Loan shall be paid in arrears on each Interest Payment Date. Interest on each Overdraft Advance shall be paid on the earlier to occur of the date of repayment of such Advance or the date such Advance is due and payable. All amounts owing the Banks on account of an Overdraft Advance and all amounts owing to a Swap Bank or any Affiliate of a Swap Bank with respect to any Swap Contract, to the extent such amounts have not been repaid from the proceeds of a Revolving Loan on the first (1st) Business Day after the Co-Borrowers receive notice that such amount was advanced by or becomes owing to the Banks or such Swap Bank or any of their Affiliates.

(c) Notwithstanding subsection (a) of this Section, if any amount of principal of or interest on any Loan, or any other amount payable hereunder or under any other Loan Document is not paid in full when due (whether at stated maturity, by acceleration, or otherwise), the Co-Borrowers agree to pay interest on such unpaid principal or other amount, from the date such amount becomes due until the date such amount is paid in full, and after as well as before any entry of judgment thereon to the extent permitted by law, payable on demand, at a fluctuating rate per annum equal to the Default Rate.

(d) Anything herein to the contrary notwithstanding, the Obligations of the Co-Borrowers to any Bank hereunder shall be subject to the limitation that payments of interest shall not be required for any period for which interest is computed hereunder, to the extent (but only to the extent) that contracting for or receiving such payment by such Bank would be contrary to the provisions of any law applicable to such Bank limiting the highest rate of interest that may be lawfully contracted for, charged or received by such Bank, and in such event the Co-Borrowers shall pay such Bank interest at the highest rate permitted by applicable law.

(e) Regardless of any provision contained in any Note or in any of the Loan Documents, none of the Banks shall ever be deemed to have contracted for or be entitled to receive, collect or apply as interest under any such Note or any Loan Document, or otherwise, any amount in excess of the maximum rate of interest permitted to be charged by applicable law, and, in the event that any of the Banks ever receive, collect or apply as interest any such excess, such amount which would be excessive interest shall be applied to the reduction of the unpaid principal balance of the Note, and, if the principal balance of such Note and the Obligations are paid in full, any remaining excess shall forthwith be paid to Co-Borrowers. In determining whether or not the interest paid or payable under any specific contingency exceeds the highest lawful rate, the Co-Borrowers and such Bank shall, to the maximum extent permitted under applicable law, (i) characterize any non-principal payment as an expense, fee, or premium, rather than as interest, (ii) exclude voluntary prepayments and the effect thereof, and (iii) spread the total amount of interest throughout the entire contemplated term of such Note and the Obligations so that the interest rate is uniform throughout such term; provided, that if all Obligations under the Note and all Loan Documents are performed in full prior to the end of the full contemplated term thereof, and if the interest received for the actual term thereof exceeds the

maximum lawful rate, such Bank shall refund to Co-Borrowers the amount of such excess, or credit the amount of such excess against the aggregate unpaid principal balance of such Bank's Note or Obligations at the time in question.

2.09 Fees.

(a) Agent and Facility Fees. In addition to certain fees described in Section 3.08, the Co-Borrowers shall pay an Agent's fee to BNP Paribas and Fortis in accordance with separate letter agreements between BNP Paribas, Fortis and the Co-Borrowers.

(b) Commitment Fee. In consideration of each Bank's commitment to make Loans and to issue Letters of Credit, the Co-Borrowers will pay to the Administrative Agent for the account of each Bank a commitment fee determined on a daily basis following the Closing Date by applying a rate equal to three-eighths of one percent (0.375%) per annum to such Bank's Pro Rata Share of the unused portion of the Facility Amount on each day, determined for each such day by deducting from the Facility Amount at the end of such day the outstanding amounts under the Credit Lines. This commitment fee shall be due and payable in arrears on the last day of each Fiscal Quarter (beginning September 1, 2003) and at the Expiration Date.

2.10 Computation of Fees and Interest.

(a) All computations of fees and interest shall be made on the basis of a 360-day year and actual days elapsed (which results in more interest being paid than if computed on the basis of a 365-day year). Interest and fees shall accrue during each period during which interest or such fees are computed from the first day thereof through the last day thereof.

(b) Each determination of an interest rate by the Administrative Agent shall be conclusive and binding on the Co-Borrowers and the Banks in the absence of manifest error.

2.11 Payments by the Co-Borrowers.

(a) All payments to be made by the Co-Borrowers shall be made without set-off, recoupment or counterclaim. Except as otherwise expressly provided herein, all payments by the Co-Borrowers shall be made to the Administrative Agent for the account of the Banks at the Administrative Agent's Payment Office, and shall be made in dollars and in immediately available funds, no later than 3:00 p.m. (New York City time) on the date specified herein. The Administrative Agent will promptly (and in no event later than the next Business Day) distribute to each Bank its Pro Rata Share of such payment in like funds as received. Any payment received by the Administrative Agent later than 3:00 p.m. (New York City time) shall be deemed to have been received on the following Business Day and any applicable interest or fee shall continue to accrue. If and to the extent the Co-Borrowers make any payment to the Administrative Agent no later than 3:00 p.m. (New York City time) on any Business Day and Administrative Agent does not distribute to each Bank its Pro Rata Share of such payment in like funds as received on the same Business Day, the Administrative Agent shall pay to each Bank on demand interest on such amount as should have been distributed to such Bank at the Federal Funds Rate for each day from the date such payment was received by the Administrative Agent

until the date such amount is received by such Bank and the Co-Borrowers shall have no obligation to reimburse the Administrative Agent for any such interest notwithstanding anything to the contrary contained herein.

(b) Subject to the provisions set forth in the definition of "Interest Period" herein, whenever any payment is due on a day other than a Business Day, such payment shall be made on the following Business Day, and such extension of time shall in such case be included in the computation of interest or fees, as the case may be.

(c) Unless the Administrative Agent receives notice from the Co-Borrowers prior to the date on which any payment is due to the Banks that the Co-Borrowers will not make such payment in full as and when required, the Administrative Agent may assume that the Co-Borrowers have made such payment in full to the Administrative Agent on such date in immediately available funds and the Administrative Agent may (but shall not be so required), in reliance upon such assumption, distribute to each Bank on such due date an amount equal to the amount then due such Bank. If and to the extent the Co-Borrowers have not made such payment in full to the Administrative Agent, each Bank shall repay to the Administrative Agent on demand such amount distributed to such Bank, together with interest thereon at the Federal Funds Rate for each day from the date such amount is distributed to such Bank until the date repaid.

2.12 Payments by the Banks to the Administrative Agent. If and to the extent any Bank shall not have made its full amount available to the Administrative Agent in immediately available funds and the Administrative Agent in such circumstances has made available to the Co-Borrowers such amount, that Bank shall on the Business Day following such Borrowing Date make such amount available to the Administrative Agent, together with interest at the Federal Funds Rate for each day during such period. A notice of the Administrative Agent submitted to any Bank with respect to amounts owing under this Section 2.12 shall be conclusive, absent manifest error. If such amount is so made available, such payment to the Administrative Agent shall constitute such Bank's Loan on the date of Borrowing for all purposes of this Agreement. If such amount is not made available to the Administrative Agent on the Business Day following the Borrowing Date, the Administrative Agent will notify the Co-Borrowers of such failure to fund and, upon demand by the Administrative Agent, the Co-Borrowers shall (without prejudice to Co-Borrowers rights against such Bank) pay such amount to the Administrative Agent for the Administrative Agent's account, together with interest thereon for each day elapsed since the date of such Borrowing, at a rate per annum equal to the interest rate applicable at the time to the Loans comprising such Borrowing.

2.13 Sharing of Payments, Etc. If, other than as expressly provided elsewhere herein, any Bank or Affiliate which is a Swap Bank shall obtain on account of the Loans made by it or obligations owed to it under a Swap Contract, any payment (whether voluntary, involuntary, through the exercise of any right of set-off, or otherwise) in excess of its Pro Rata Share or Adjusted Pro Rata Share, as the case may be at such time (other than payments that are made to Swap Banks and their Affiliates prior to the declaration of a Default by the Required Banks and payments to the Banks with respect to Overdraft Advances, which payments may be retained by the Banks such Swap Banks and their Affiliates), such Bank shall immediately (a) notify the

Administrative Agent of such fact, and (b) purchase from the other Banks such participations in the Loans and obligations under Swap Contracts made by such other Banks as shall be necessary to cause such purchasing Bank to share the excess payment pro rata with each of them; provided, however, that if all or any portion of such excess payment is thereafter recovered from the purchasing Bank, such purchase shall to that extent be rescinded and each other Bank shall repay to the purchasing Bank the purchase price paid therefore, together with an amount equal to such paying Bank's ratable share (according to the proportion of (i) the amount of such paying Bank's required repayment to (ii) the total amount so recovered from the purchasing Bank) of any interest or other amount paid or payable by the purchasing Bank in respect of the total amount so recovered. The Co-Borrowers agree that any Bank so purchasing a participation from another Bank may, to the fullest extent permitted by law, exercise all its rights of payment (including the right of set-off, but subject to Section 11.09) with respect to such participation as fully as if such Bank were the direct creditor of the Co-Borrowers in the amount of such participation. The Administrative Agent will keep records (which shall be conclusive and binding in the absence of manifest error) of participations purchased under this Section and will in each case notify the Banks following any such purchases or repayments.

2.14 Payments from Guarantors and Liquidation of Collateral. Notwithstanding anything to the contrary contained herein, in the event that after a Default is declared repayment is made to the Banks by the Guarantors or made pursuant to a liquidation of Collateral, whether by setoff or otherwise, such repayment shall be shared by the Banks on the basis of each Bank's then existing Adjusted Pro Rata Share rather than each Bank's Pro Rata Share. If Required Banks declare a Default or Event of Default, the Swap Banks upon vote of the Required Banks immediately shall terminate all Swap Contracts, and no distribution shall be made to the Banks before establishing the Adjusted Pro Rata Shares of all the Banks taking into account the Obligations to the Swap Banks under the Swap Contracts, including Obligations arising as a result of such termination. If the Required Banks do not vote to cause the termination of the Swap Contracts, after all such repayments are made to the Banks by the Guarantors or made pursuant to such liquidation of Collateral, the total amount received by any Bank from all such payments or repayments following such declaration of a Default exceeds such Bank's Aggregate Credit Exposure Percentage of all such payments or repayments, then the Banks shall purchase participations in each other's Obligations so that after giving effect to such purchases of participations, each Bank shall have received its Aggregate Credit Exposure Percentage of all such payments or repayments.

ARTICLE III

THE LETTERS OF CREDIT

3.01 The Letters of Credit Lines

(a) On the terms and conditions set forth herein, the Issuing Banks, with the consent of each Agent, agree, from time to time on any Business Day during the period from the Closing Date to the Expiration Date, to Issue Letters of Credit for the account of the Co-Borrowers under the Borrowing Base Line or the Collateralized L/C Line, and to consider whether to amend or renew Letters of Credit previously Issued by it, in accordance with

Subsections 3.02(c) and 3.02(d). Each of the Banks will be deemed to have approved such Issuance, amendment or renewal, and shall participate in Letters of Credit Issued for the account of the Co-Borrowers. Subject to the terms and conditions hereof, the Co-Borrowers' ability to request that the Issuing Banks Issue Letters of Credit shall be fully revolving, and, accordingly, the Co-Borrowers may, during the foregoing period, request that the Issuing Banks Issue Letters of Credit to replace Letters of Credit which have expired or which have been drawn upon and reimbursed.

(b) An Issuing Bank is under no obligation to consider the Issuance of or to Issue any Letter of Credit unless each Agent shall have consented to the Issuance of such Letter of Credit. An Issuing Bank shall not Issue any Letter of Credit unless consented to by each Agent, if:

(i) any order, judgment or decree of any Governmental Authority or arbitrator shall by its terms purport to enjoin or restrain the Issuing Bank from Issuing such Letter of Credit, or any Requirement of Law applicable to the Issuing Bank or any request or directive (whether or not having the force of law) from any Governmental Authority with jurisdiction over the Issuing Bank shall prohibit, or request that the Issuing Bank refrain from, the issuance of letters of credit generally or such Letter of Credit in particular or shall impose upon the Issuing Bank with respect to such Letter of Credit any restriction, reserve or capital requirement (for which the Issuing Bank is not otherwise compensated hereunder) not in effect on the Closing Date, or shall impose upon the Issuing Bank any unreimbursed loss, cost or expense which was not applicable on the Closing Date and which the Issuing Bank in good faith deems material to it;

(ii) the Issuing Bank has received written notice from any Bank, the Administrative Agent or the Co-Borrowers, on or prior to the Business Day prior to the requested date of Issuance of such Letter of Credit, that one or more of the applicable conditions contained in Article V is not then satisfied;

(iii) the expiry date of any requested Letter of Credit is after the earlier to occur of (A) in the case of Letters of Credit Issued under the Borrowing Base Line, 364 days after the date of Issuance of such Letter of Credit or in the case of Letters of Credit Issued under the Collateralized L/C Line, two years after the date of Issuance of the Letter of Credit, or (B) the Maturity Date, unless all the Banks have approved such expiry date in writing, except that any Letter of Credit with a term of 364 days may also contain a so-called evergreen provision which provides for a 60-day notice of cancellation;

(iv) such requested Letter of Credit is not in form and substance acceptable to the Issuing Bank, or the Issuance of a Letter of Credit shall violate any applicable policies of the Issuing Bank;

(v) such Letter of Credit is for the purpose of supporting the Issuance of any letter of credit by any other Person;

(vi) such Letter of Credit is denominated in a currency other than Dollars or Canadian dollars;

(vii) the Issuance of such requested Letter of Credit exceeds the applicable L/C Sub-limit;

(viii) the Effective Amount of such requested Letter of Credit to be issued under the Borrowing Base Line plus the Effective Amount of all of the L/C Obligations (for Letters of Credit issued under the Borrowing Base Line), plus the Effective Amount of all Revolving Loans, exceeds the Borrowing Base Cap; and

(ix) if the requested Letter of Credit is to be issued under the Collateralized L/C Line: (a) the face amount of such Letter of Credit has not been Cash Collateralized, (b) after taking into account the requested Letter of Credit, the Collateralized L/C Line would be exceeded, or (c) after taking into account the requested Letter of Credit, the aggregate outstanding amounts under the Collateralized L/C Line and the Borrowing Base Line would exceed the Facility Amount.

(c) For purposes of this Article III, in determining whether to consent to the Issuance of a Letter of Credit, the Agents shall rely exclusively on the criteria set forth in Subsection 3.01(b). That is, the Agents may only refuse to consent to the Issuance of a Letter of Credit if, in their judgment, it falls within one of the categories (i) through (x), set forth in Subsection 3.01(b).

3.02 Issuance, Amendment and Renewal of Letters of Credit.

(a) Each Letter of Credit which is Issued hereunder shall be Issued upon the irrevocable written request of a Co-Borrower pursuant to a Notice of Borrowing (Letter of Credit) in the applicable form attached hereto as Exhibit A received by the Issuing Bank (with a copy sent by the Co-Borrowers to the Administrative Agent) by no later than 1:00 p.m. (New York City time) on the proposed date of Issuance. Each such request for Issuance of a Letter of Credit shall be by electronic transfer or facsimile, confirmed immediately in an original writing (delivered by facsimile without any requirement of confirmation by telephone) in the applicable form attached hereto as Exhibit A, and shall specify in form and detail satisfactory to the Issuing Bank: (i) the identity of the Issuing Bank and the proposed date of Issuance of the Letter of Credit (which shall be a Business Day); (ii) the face amount and currency of the Letter of Credit; (iii) the expiry date of the Letter of Credit; (iv) the name and address of the beneficiary thereof; (v) the documents to be presented by the beneficiary of the Letter of Credit in case of any drawing thereunder; (vi) the full text of any certificate to be presented by the beneficiary in case of any drawing thereunder; (vii) whether the Letter of Credit is to be issued under the Borrowing Base Line or the Collateralized L/C Line; and (viii) such other matters as the Issuing Bank may require.

(b) From time to time while a Letter of Credit is outstanding and prior to the Expiration Date, the Issuing Bank, but solely with the consent of each Agent will, upon the

written request of a Co-Borrower received by Issuing Bank (with a copy sent by the Co-Borrowers to Administrative Agent) prior to 1:00 p.m. (New York City time) on the proposed date of amendment, consider the amendment of any Letter of Credit issued by it. Each such request for amendment of a Letter of Credit shall be made by electronic transfer or facsimile, confirmed immediately in an original writing or by electronic transfer, made in the form of an L/C Amendment Application and shall specify in form and detail satisfactory to the Issuing Bank: (i) the Letter of Credit to be amended; (ii) the proposed date of amendment of the Letter of Credit (which shall be a Business Day); (iii) the nature of the proposed amendment; and (iv) such other matters as the Issuing Bank may require. The Administrative Agent will promptly notify the Banks of the receipt by it of any L/C Application or L/C Amendment Application.

(c) The Issuing Banks and the Banks agree that, while a Letter of Credit is outstanding and prior to the Expiration Date, at the option of the Co-Borrowers and upon the written request of the Co-Borrowers received by the Issuing Bank (with a copy sent to the Administrative Agent) at least one Business Day (or such shorter time as the Banks and the Issuing Bank may agree in a particular instance in their sole discretion) prior to the proposed date of notification of renewal. Each such request for renewal of a Letter of Credit made by a Co-Borrower shall be made by electronic transfer or facsimile, confirmed immediately in an original writing or by electronic transfer, in the form of an L/C Amendment Application, and shall specify in form and detail satisfactory to the Issuing Bank: (i) the Letter of Credit to be renewed; (ii) the proposed date of renewal of the Letter of Credit (which shall be a Business Day); (iii) the revised expiry date of the Letter of Credit; and (iv) such other matters as the Issuing Bank may require. If any outstanding Letter of Credit shall provide that it shall be automatically renewed unless the beneficiary thereof receives notice from the Issuing Bank that such Letter of Credit shall not be renewed, and if at the time of renewal the Issuing Bank would be entitled to authorize the automatic renewal of such Letter of Credit in accordance with this Subsection 3.02(c) upon the request of the Co-Borrowers, then the Issuing Bank shall nonetheless be permitted to allow such Letter of Credit to renew, and the Co-Borrowers and the Banks hereby authorize such renewal, and, accordingly, the Issuing Bank shall be deemed to have received an L/C Amendment Application from the Co-Borrowers requesting such renewal.

(d) An Issuing Bank may not agree to any request to Issue, amend, renew or extend a Letter of Credit without the prior consent of each Agent.

(e) An Issuing Bank may, at its election, deliver any notices of termination or other communications to any Letter of Credit beneficiary or transferee, and take any other action as necessary or appropriate, at any time and from time to time, in order to cause the expiry date of such Letter of Credit to be a date not later than the Maturity Date.

(f) This Agreement shall control in the event of any conflict with any L/C-Related Document (other than any Letter of Credit).

(g) The Issuing Bank will also deliver to the Administrative Agent a true and complete copy of each Letter of Credit or amendment to or renewal of a Letter of Credit. The Administrative Agent shall provide a report to each Bank of each Issuance, amendment, renewal,

extension or cancellation of a Letter of Credit, such report to be provided promptly after each such action.

3.03 Risk Participations, Drawings, Reducing Letters of Credit and Reimbursements.

(a) Immediately upon the Issuance of each Letter of Credit, each Bank shall be deemed to, and hereby irrevocably and unconditionally agrees to, purchase from the Issuing Bank a participation in such Letter of Credit and each drawing or Reducing L/C Borrowing thereunder in an amount equal to the product of (i) the Pro Rata Share of such Bank, times (ii) the maximum amount available to be drawn under such Letter of Credit and the amount of such drawing or Reducing Letter of Credit Borrowing, respectively. For purposes of Section 2.01, each Issuance of a Letter of Credit shall be deemed to utilize the Line Portion of each Bank by an amount equal to the amount of such participation.

(b) In the event of any request for a drawing under a Letter of Credit by the beneficiary or transferee thereof, the Issuing Bank will promptly notify the Co-Borrowers. Any notice given by an Issuing Bank or the Administrative Agent pursuant to this Subsection 3.03(b) may be oral if immediately confirmed in writing (including by facsimile); provided that the lack of such an immediate confirmation shall not affect the conclusiveness or binding effect of such notice. The Co-Borrowers shall reimburse the Issuing Bank in the relevant currency prior to 5:00 p.m. (New York City time), on each date that any amount is paid by the Issuing Bank under any Letter of Credit or to the beneficiary of a Reducing Letter of Credit in the form of a Reducing L/C Borrowing (each such date, an "Honor Date"), in an amount equal to the amount so paid by the Issuing Bank. In the event the Co-Borrowers fail to reimburse the Issuing Bank for the full amount of any drawing under any Letter of Credit or of any Reducing L/C Borrowing, as the case may be, by 5:00 p.m. (New York City time) on the Honor Date, the Issuing Bank will promptly notify the Administrative Agent and the Administrative Agent will promptly notify each Bank thereof, and the Banks shall reimburse the Issuing Bank for the amount of the drawing under the Letter of Credit or Reducing L/C Borrowing, as the case may be. Under such circumstances, the Co-Borrowers shall be deemed to have requested that Dollar Advances be made by the Banks to be disbursed to the Issuing Bank not later than one (1) Business Day after the Honor Date under such Letter of Credit.

(c) In the event of any request for a Reducing L/C Borrowing by the Co-Borrowers in association with any Reducing Letter of Credit, the amount available for drawing under such Reducing Letter of Credit will be reduced automatically, and without any further amendment or endorsement to such Reducing Letter of Credit, by the amount actually paid to such beneficiary, notwithstanding the fact that the payment creating such Reducing L/C Borrowing is not made pursuant to a conforming and proper draw under the corresponding Reducing Letter of Credit.

(d) Each Bank shall upon any notice pursuant to Subsection 3.03(b) make available to the Administrative Agent for the account of the Issuing Bank an amount in Dollars and in immediately available funds equal to its Pro Rata Share of the Dollar Equivalent amount of the drawing or of the Reducing L/C Borrowing, as the case may be, whereupon the Banks shall (subject to Subsection 3.03(e)) each be deemed to have made a Dollar Advance to the

Co-Borrowers in that amount. If any Bank so notified fails to make available to the Administrative Agent for the account of the Issuing Bank the amount of such Bank's Pro Rata Share of the amount of the drawing or of the Reducing L/C Borrowing, as the case may be, by no later than 3:00 p.m. (New York City time) on the Business Day following the Honor Date, then interest shall accrue on such Bank's obligation to make such payment, from the Honor Date to the date such Bank makes such payment, at a rate per annum equal to (i) the Federal Funds Rate in effect from time to time during such period for the first two Business Days and (ii) thereafter, the Federal Funds Rate in effect from time to time during such period, plus two percent (2.00%). The Administrative Agent will promptly give notice of the occurrence of the Honor Date, but failure of the Administrative Agent to give any such notice on the Honor Date or in sufficient time to enable any Bank to effect such payment on such date shall not relieve such Bank from its obligations under this Section 3.03.

(e) With respect to any unreimbursed drawing or Reducing L/C Borrowing, as the case may be, that is not converted into Dollar Advances in whole or in part for any reason, the Co-Borrowers shall be deemed to have incurred from the relevant Issuing Bank an L/C Borrowing in the amount of such drawing or Reducing L/C Borrowing, as the case may be, which L/C Borrowing shall be due and payable on demand (together with interest) and shall bear interest at a rate per annum equal to the Default Rate, and each Bank's payment to such Issuing Bank pursuant to Subsection 3.03(e) shall be deemed payment in respect of its participation in such L/C Borrowing and shall constitute an L/C Advance from such Bank in satisfaction of its participation obligation under this Section 3.03.

(f) In the event that payment under any Letter of Credit is drawn or purported to be drawn in a currency other than United States Dollars, the amount of reimbursement to the Issuing Bank therefor shall be calculated on the basis of the Issuing Bank's selling rate of exchange in effect (for the date on which the Issuing Bank pays such draft or reimburses any of its correspondents which paid such draft) for cable transfers to the place where and in the currency in which such draft is payable. The Co-Borrowers shall comply with any and all governmental exchange regulations now or hereafter applicable to any foreign exchange, and shall indemnify and hold the Banks harmless from any failure of the Co-Borrowers so to comply. If for any cause whatsoever, there exists at the time in question no rate of exchange generally current at Issuing Bank for effective cable transfer of the sort above provided for, the Co-Borrowers agree to pay the Banks on demand an amount in United States Dollars equivalent to the actual cost of settlement of the Issuing Bank's obligation to the payor of the draft or acceptance or any holder thereof, as the case may be, and however and whenever such settlement may be made by the Issuing Bank.

(g) Each Bank's obligation in accordance with this Agreement to make the Revolving Loans or L/C Advances, as contemplated by this Section 3.03, as a result of a drawing under a Letter of Credit or Reducing L/C Borrowing, shall be absolute and unconditional and without recourse to the relevant Issuing Bank and shall not be affected by any circumstance, including (i) any set-off, counterclaim, recoupment, defense or other right which such Bank may have against such Issuing Bank, the Co-Borrowers or any other Person for any reason whatsoever; (ii) the occurrence or continuance of a Default, an Event of Default or a Material

Adverse Effect; or (iii) any other circumstance, happening or event whatsoever, whether or not similar to any of the foregoing.

3.04 Repayment of Participations.

(a) Upon (and only upon) receipt by the Administrative Agent for the account of the Issuing Bank of immediately available funds from the Co-Borrowers (i) in reimbursement of any payment made by Issuing Bank under the Letter of Credit or in connection with a Reducing L/C Borrowing with respect to which any Bank has paid the Administrative Agent for the account of the Issuing Bank for such Bank's participation in the Letter of Credit or funded a Dollar Advance pursuant to Section 3.03 or (ii) in payment of interest thereon, the Administrative Agent will pay to each Bank, in the same funds as those received by the Administrative Agent for the account of the Issuing Bank, the amount of such Bank's Pro Rata Share of such funds, and the Issuing Bank shall receive the amount of the Pro Rata Share of such funds of any Bank that did not so pay the Administrative Agent for the account of the Issuing Bank.

(b) If the Administrative Agent or an Issuing Bank is required at any time to return to the Co-Borrowers, or to a trustee, receiver, liquidator, custodian, or any official in any Insolvency Proceeding, any portion of the payments made by the Co-Borrowers to the Administrative Agent for the account of the Issuing Bank which shall have been paid to the Banks pursuant to Subsection 3.04(a), each Bank shall, on demand of the Issuing Bank, forthwith return to the Administrative Agent or the Issuing Bank the amount of its Pro Rata Share of any amounts so returned by the Administrative Agent or the Issuing Bank plus interest thereon from the date such demand is made to the date such amounts are returned by such Bank to the Administrative Agent or the Issuing Bank, at a rate per annum equal to (i) the Federal Funds Rate in effect from time to time during such period for the first two Business Days and (ii) thereafter, the Federal Funds Rate in effect from time to time during such period, plus two percent (2.00%).

3.05 Role of the Issuing Bank.

(a) Each Bank and the Co-Borrowers agree that, in paying any drawing under a Letter of Credit or funding any Reducing L/C Borrowing, Issuing Bank shall not have any responsibility to obtain any document (other than any sight draft or certificates expressly required by the Letter of Credit, but with respect to Reducing Letter of Credit Borrowings, no document of any kind need be obtained) or to ascertain or inquire as to the validity or accuracy of any such document or the authority of the Person executing or delivering any such document.

(b) No Agent-Related Person nor any of the respective correspondents, participants or assignees of Issuing Bank shall be liable to any Bank for: (i) any action taken or omitted in connection herewith at the request or with the approval or deemed approval of the Banks; (ii) any action taken or omitted in the absence of gross negligence or willful misconduct; or (iii) the due execution, effectiveness, validity or enforceability of any L/C-Related Document.

(c) The Co-Borrowers hereby assume all risks of the acts or omissions of any beneficiary or transferee with respect to its use of any Letter of Credit; provided, however, that this assumption is not intended to, and shall not, preclude a Co-Borrower from pursuing such rights and remedies as it may have against the beneficiary or transferee at law or under any other agreement. No Agent-Related Person, nor any of the respective correspondents, participants or assignees of Issuing Bank shall be liable or responsible for any of the matters described in clauses (a) through (g) of Section 3.06; provided, however, anything in such clauses or elsewhere herein to the contrary notwithstanding, that the Co-Borrowers may have a claim against Issuing Bank, and Issuing Bank may be liable to the Co-Borrowers, to the extent, but only to the extent, of any direct, as opposed to consequential or exemplary, damages suffered by the Co-Borrowers which the Co-Borrowers prove were caused by Issuing Bank's willful misconduct or gross negligence or Issuing Bank's willful failure to pay under any Letter of Credit after the presentation to it by the beneficiary of a sight draft and certificate(s) strictly complying with the terms and conditions of a Letter of Credit. In furtherance and not in limitation of the foregoing: (i) Issuing Bank may accept documents that appear on their face to be in order, without responsibility for further investigation, regardless of any notice or information to the contrary; and (ii) Issuing Bank shall not be responsible for the validity or sufficiency of any instrument transferring or assigning or purporting to transfer or assign a Letter of Credit or the rights or benefits thereunder or proceeds thereof, in whole or in part, which may prove to be invalid or ineffective for any reason.

3.06 Obligations Absolute. The Obligations of the Co-Borrowers under this Agreement and any L/C-Related Document to reimburse Issuing Bank for a drawing under a Letter of Credit or for a Reducing L/C Borrowing, and to repay any L/C Borrowing and any drawing under a Letter of Credit or Reducing L/C Borrowing converted into Revolving Loans, shall be unconditional and irrevocable, and shall be paid strictly in accordance with the terms of this Agreement and each such other L/C-Related Document under all circumstances, including the following:

(a) any lack of validity or enforceability of this Agreement or any L/C-Related Document;

(b) any change in the time, manner or place of payment of, or in any other term of, all or any of the Obligations of the Co-Borrowers in respect of any Letter of Credit or any other amendment or waiver of or any consent to departure from all or any of the L/C-Related Documents;

(c) the existence of any claim, set-off, defense or other right that the Co-Borrowers may have at any time against any beneficiary or any transferee of any Letter of Credit (or any Person for whom any such beneficiary or any such transferee may be acting), the Issuing Bank or any other Person, whether in connection with this Agreement, the transactions contemplated hereby or by the L/C-Related Documents or any unrelated transaction;

(d) any draft, demand, certificate or other document presented under any Letter of Credit proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect; or any loss or delay in the

transmission or otherwise of any document required in order to make a drawing under any Letter of Credit;

(e) any payment by the Issuing Bank under any Letter of Credit against presentation of a draft or certificate that does not strictly comply with the terms of any Letter of Credit; or any payment made by the Issuing Bank under any Letter of Credit to any Person purporting to be a trustee in bankruptcy, debtor-in-possession, assignee for the benefit of creditors, liquidator, receiver or other representative of or successor to any beneficiary or any transferee of any Letter of Credit, including any arising in connection with any Insolvency Proceeding;

(f) any exchange, release or non-perfection of any collateral, or any release or amendment or waiver of or consent to departure from any other guarantee, for all or any of the Obligations of the Co-Borrowers in respect of any Letter of Credit; or

(g) any other circumstance or happening whatsoever, whether or not similar to any of the foregoing, including any other circumstance that might otherwise constitute a defense available to, or a discharge of, the Co-Borrowers or Guarantor.

3.07 Cash Collateral Pledge. Upon the request of the Administrative Agent, (i) if Issuing Bank has honored any full or partial drawing request on any Letter of Credit and such drawing has resulted in an L/C Borrowing hereunder, or (ii) if, as of the Expiration Date, any Letters of Credit may for any reason remain outstanding and partially or wholly undrawn, the Co-Borrowers shall immediately Cash Collateralize the L/C Obligations in an amount equal to such L/C Obligations. Upon the occurrence of the circumstances described in Section 2.06 requiring the Co-Borrowers to Cash Collateralize Letters of Credit, then, the Co-Borrowers shall immediately Cash Collateralize the L/C Obligations in an amount equal to the applicable excess. In addition, the Co-Borrowers shall Cash Collateralize any Letter of Credit to be Issued under the Collateralized L/C Line on or before such Letter of Credit is actually Issued in an amount equal to such Letter of Credit.

3.08 Letter of Credit Fees.

(a) The Co-Borrowers shall pay to the Administrative Agent for the account of each of the Banks in accordance with their Pro Rata Shares a letter of credit fee with respect to each of the Letters of Credit Issued hereunder as follows:

(i) Trade Related L/Cs, Swap L/Cs and Performance L/Cs - the greater of (A) $250.00 or (B) the amount set forth in the following grid;

Type of LC	**Margin**
Trade Related L/Cs with a tenor of three months or less	1.50% per annum
Trade Related L/Cs with a tenor of longer than three months but less than 365 days	1.75% per annum
Performance L/Cs and Swap L/Cs	2.00% per annum

(ii) Cash Collateralized Letters of Credit - the greater of (A) .50 % per annum or (B) $250.00.

Such letter of credit fee for each Letter of Credit shall be due and payable monthly in arrears for the preceding month during which Letters of Credit are outstanding, based on the maximum Dollar amount of each L/C outstanding during such month, commencing on the first such monthly date to occur after the Closing Date.

(b) The Co-Borrowers shall pay to the Agents and the Issuing Banks, such other Letter of Credit Fees as may be provided for by separate letter agreement between the Agents, the Issuing Banks and the Co-Borrowers.

(c) With reference to Letter of Credit fees for all Letters of Credit denominated in Canadian dollars, Administrative Agent shall calculate their Dollar Equivalents for each month in advance based upon the Canadian dollar/US Dollar exchange rate in effect, as determined by Administrative Agent as of the first calendar day of such month (without limiting Administrative Agent's right to determine the Dollar Equivalent at any time as provided in the definition of "Effective Amount"). Such Dollar Equivalents shall be used for calculating the amount of such fees. New Letters of Credit denominated in Canadian dollars shall be assigned Dollar Equivalents by Administrative Agent and such Dollar Equivalents shall apply until the next succeeding Dollar Equivalents are calculated by Administrative Agent.

3.09 Uniform Customs and Practice. The Uniform Customs and Practice for Documentary Credits as published by the International Chamber of Commerce most recently at the time of Issuance of any Letter of Credit shall (unless otherwise expressly provided in the Letters of Credit) apply to the Letters of Credit.

ARTICLE IV

TAXES, YIELD PROTECTION AND ILLEGALITY

4.01 Taxes.

(a) Any and all payments by the Co-Borrowers to each Bank or the Administrative Agent under this Agreement and any other Loan Document shall be made free and clear of, and without deduction or withholding for, any Taxes. In addition, the Co-Borrowers shall pay all Other Taxes.

(b) If the Co-Borrowers shall be required by law to deduct or withhold any Taxes, Other Taxes or Further Taxes from or in respect of any sum payable hereunder to any Bank or the Administrative Agent, then:

(i) the sum payable shall be increased as necessary so that after making all required deductions and withholdings (including deductions and withholdings applicable to additional sums payable under this Section) such Bank or the Administrative Agent, as the case may be, receives and retains an amount equal to the sum it would have received and retained had no such deductions or withholdings been made;

(ii) the Co-Borrowers shall make such deductions and withholdings;

(iii) the Co-Borrowers shall pay the full amount deducted or withheld to the relevant taxing authority or other authority in accordance with applicable law; and

(iv) the Co-Borrowers shall also pay to each Bank or the Administrative Agent for the account of such Bank, at the time interest is paid, Further Taxes in the amount that Bank specifies as necessary to preserve the after-tax yield the Bank would have received if such Taxes, Other Taxes or Further Taxes had not been imposed.

(c) The Co-Borrowers agree to indemnify and hold harmless each Bank and the Administrative Agent for the full amount of (i) Taxes, (ii) Other Taxes, and (iii) Further Taxes in the amount that Administrative Agent or such Bank specifies as necessary to preserve the after-tax yield Administrative Agent or such Bank would have received if such Taxes, Other Taxes or Further Taxes had not been imposed, and any liability (including penalties, interest, additions to tax and expenses) arising therefrom or with respect thereto, whether or not such Taxes, Other Taxes or Further Taxes were correctly or legally asserted, provided, however, that the Co-Borrowers shall not be required to indemnify or hold harmless any Bank to the extent (but only to the extent) of such Bank's gross negligence or willful misconduct. Payment under this indemnification shall be made within 30 days after the date the Bank or the Administrative Agent makes written demand therefor.

(d) Within 30 days after the date of any payment by the Co-Borrowers of Taxes, Other Taxes or Further Taxes, the Co-Borrowers shall furnish the Administrative Agent the original or a certified copy of a receipt evidencing payment thereof, or other evidence of payment satisfactory to the Administrative Agent.

(e) If the Co-Borrowers are required to pay any amount to Administrative Agent or any Bank pursuant to subsection (b) or (c) of this Section, then such Bank shall use reasonable efforts (consistent with legal and regulatory restrictions) to change the jurisdiction of its Lending Office so as to eliminate any such additional payment by the Co-Borrowers which may thereafter accrue, if such change in the judgment of such Bank is not otherwise disadvantageous to such Bank.

4.02 Withholding Tax.

(a) If any Bank is a "foreign corporation, partnership or trust" within the meaning of the Code and such Bank claims exemption from, or a reduction of, U.S. withholding tax under Sections 1441 or 1442 of the Code, such Bank agrees with and in favor of the Administrative Agent, to deliver to the Administrative Agent:

(i) if such Bank claims an exemption from, or a reduction of, withholding tax under a United States tax treaty, properly completed and executed copies of IRS Form W-8BEN before the payment of any interest in the first calendar year and before the payment of any interest in each third succeeding calendar year during which interest may be paid under this Agreement;

(ii) if such Bank claims that interest paid under this Agreement is exempt from United States withholding tax because it is effectively connected with a United States trade or business of such Bank, two properly completed and executed copies of IRS Form W-8ECI before the payment of any interest is due in the first taxable year of such Bank and in each succeeding taxable year of such Bank during which interest may be paid under this Agreement; and

(iii) such other form or forms as may be required under the Code or other laws of the United States as a condition to exemption from, or reduction of, United States withholding tax.

Such Bank agrees to promptly notify the Administrative Agent of any change in circumstances which would modify or render invalid any claimed exemption or reduction.

(b) If any Bank claims exemption from, or reduction of, withholding tax under a United States tax treaty by providing IRS Form W-8BEN and such Bank sells, assigns, grants a participation in, or otherwise transfers all or part of the Obligations of the Co-Borrowers to such Bank, such Bank agrees to notify the Administrative Agent of the percentage amount in which it is no longer the beneficial owner of Obligations of the Co-Borrowers to such Bank. To the extent of such percentage amount, the Administrative Agent will treat such Bank's IRS Form W-8BEN as no longer valid.

(c) If any Bank claiming exemption from United States withholding tax by filing IRS Form W-8ECI with the Administrative Agent sells, assigns, grants a participation in, or otherwise transfers all or part of the Obligations of the Co-Borrowers to such Bank, such Bank agrees to undertake sole responsibility for complying with the withholding tax requirements imposed by Sections 1441 and 1442 of the Code.

(d) If any Bank is entitled to a reduction in the applicable withholding tax, the Administrative Agent may withhold from any interest payment to such Bank an amount equivalent to the applicable withholding tax after taking into account such reduction. However, if the forms or other documentation required by subsection (a) of this Section are not delivered to the Administrative Agent, then the Administrative Agent may withhold from any interest

payment to such Bank not providing such forms or other documentation an amount equivalent to the applicable withholding tax imposed by Sections 1441 and 1442 of the Code, without reduction.

(e) If the IRS or any other Governmental Authority of the United States or other jurisdiction asserts a claim that the Administrative Agent did not properly withhold tax from amounts paid to or for the account of any Bank (because the appropriate form was not delivered, was not properly executed, or because such Bank failed to notify the Administrative Agent of a change in circumstances which rendered the exemption from, or reduction of, withholding tax ineffective, or for any other reason) such Bank shall indemnify the Administrative Agent fully for all amounts paid, directly or indirectly, by the Administrative Agent as tax or otherwise, including penalties and interest, and including any taxes imposed by any jurisdiction on the amounts payable to the Administrative Agent under this Section, together with all costs and expenses (including Attorney Costs), except to the extent caused solely by the gross negligence or willful misconduct of Administrative Agent. The obligation of the Banks under this Subsection shall survive the payment of all Obligations and the resignation or replacement of the Administrative Agent.

4.03 Illegality.

(a) If any Bank determines that the introduction of any Requirement of Law, or any change in any Requirement of Law, or in the interpretation or administration of any Requirement of Law, has made it unlawful, or that any central bank or other Governmental Authority has asserted that it is unlawful, for any Bank or its applicable Lending Office to make Eurodollar Rate Loans, then, on notice thereof by the Bank to the Co-Borrowers through the Administrative Agent, any obligation of that Bank to make Eurodollar Rate Loans shall be suspended until the Bank notifies the Administrative Agent and the Co-Borrowers that the circumstances giving rise to such determination no longer exist.

(b) If a Bank determines that it is unlawful to maintain any Eurodollar Rate Loan, the Co-Borrowers shall, upon receipt of notice of such fact and demand from such Bank (with a copy to the Administrative Agent), prepay in full, without premium or penalty, such Eurodollar Rate Loans of that Bank then outstanding, together with interest accrued thereon either on the last day of the Interest Period thereof, if the Bank may lawfully continue to maintain such Eurodollar Rate Loans to such day, or immediately, if the Bank may not lawfully continue to maintain such Eurodollar Rate Loan. If the Co-Borrowers are required to so prepay any Eurodollar Rate Loan, then concurrently with such prepayment, the Co-Borrowers shall borrow from the affected Bank, in the amount of such repayment, a Base Rate Loan.

4.04 Increased Costs and Reduction of Return.

(a) If any Bank determines that, due to either (i) the introduction of or any change (other than any change by way of imposition of or increase in reserve requirements included in the calculation of the Eurodollar Rate or in respect of the assessment rate payable by any Bank to the FDIC for insuring U.S. deposits) in or in the interpretation of any law or regulation or (ii) the compliance by that Bank with any guideline or request from any central

bank or other Governmental Authority (whether or not having the force of law), there shall be any increase in the cost to such Bank of agreeing to make or making, funding or maintaining any Eurodollar Rate Loans or participating in Letters of Credit, or, in the case of Issuing Bank, any increase in the cost to Issuing Bank of agreeing to issue, issuing or maintaining any Letter of Credit or of agreeing to make or making, funding or maintaining any unpaid drawing under any Letter of Credit, then the Co-Borrowers shall be liable for, and shall from time to time, within 30 days of demand (with a copy of such demand to be sent to the Administrative Agent), pay to the Administrative Agent for the account of such Bank, additional amounts as are sufficient to compensate such Bank for such increased costs, provided that the Co-Borrowers shall not be required to pay any such amount to the extent that such amount is reflected in changes in the Base Rate, the Eurodollar Rate or other fees or charges of such Bank.

(b) If any Bank shall have determined that (i) the introduction of any Capital Adequacy Regulation, (ii) any change in any Capital Adequacy Regulation, (iii) any change in the interpretation or administration of any Capital Adequacy Regulation by any central bank or other Governmental Authority charged with the interpretation or administration thereof, or (iv) compliance by the Bank (or its Lending Office) or any corporation controlling the Bank with any Capital Adequacy Regulation, affects or would affect the amount of capital required or expected to be maintained by the Bank or any corporation controlling the Bank and (taking into consideration such Bank's or such corporation's policies with respect to capital adequacy and such Bank's desired return on capital) determines that the amount of such capital is increased as a consequence of its loans, credits or obligations under this Agreement, then, within 30 days of demand of such Bank to the Co-Borrowers through the Administrative Agent, the Co-Borrowers shall pay to the Bank, from time to time as specified by the Bank, additional amounts sufficient to compensate the Bank for such increase, provided that the Co-Borrowers shall not be required to pay any such amount with respect to Base Rate Loans to the extent that such amount is reflected in changes in the Base Rate.

4.05 Funding Losses. The Co-Borrowers shall reimburse each Bank and hold each Bank harmless from any loss or expense which the Bank may sustain or incur as a consequence of:

(a) the failure of the Co-Borrowers to make on a timely basis any payment of principal of any Eurodollar Rate Loan;

(b) the failure of the Co-Borrowers to borrow, continue or convert a Loan after the Co-Borrowers have given (or is deemed to have given) a Notice of Borrowing or a Notice of Conversion/ Continuation;

(c) the failure of the Co-Borrowers to make any prepayment in accordance with any notice delivered under Section 2.06;

(d) the prepayment (including prepayments made pursuant to Article II but excluding prepayments made pursuant to Section 4.03) or other payment (including after acceleration thereof) of an Eurodollar Rate Loan on a day that is not the last day of the relevant Interest Period; or

(e) the automatic conversion under Section 2.04 of any Eurodollar Rate Loan to a Base Rate Loan on a day that is not the last day of the relevant Interest Period except any such automatic conversion resulting from prepayments required by Section 4.03;

including any such loss or expense arising from the liquidation or reemployment of funds obtained by it to maintain its Eurodollar Rate Loans or from fees payable to terminate the deposits from which such funds were obtained. For purposes of calculating amounts payable by the Co-Borrowers to the Banks under this Section and under Section 4.04, each Eurodollar Rate Loan made by a Bank (and each related reserve, special deposit or similar requirement) shall be conclusively deemed to have been funded at the rate used in determining the Eurodollar Rate for such Eurodollar Rate Loan by a matching deposit or other borrowing in the interbank eurodollar market for a comparable amount and for a comparable period, whether or not such Eurodollar Rate Loan is in fact so funded.

4.06 Inability to Determine Rates. If the Administrative Agent and the Banks determine that for any reason adequate and reasonable means do not exist for determining the Eurodollar Rate for any requested Interest Period with respect to a proposed Eurodollar Rate Loan, or that the Eurodollar Rate applicable pursuant to Subsection 2.08(a) for any requested Interest Period with respect to a proposed Eurodollar Rate Loan does not adequately and fairly reflect the cost to the Banks of funding such Loan, the Administrative Agent will promptly so notify the Co-Borrowers and each Bank. Thereafter, the obligation of the Banks to make or maintain Eurodollar Rate Loans, as the case may be, hereunder shall be suspended until the Administrative Agent upon the instruction of the Banks revokes such notice in writing. Upon receipt of such notice, the Co-Borrowers may revoke any Notice of Borrowing or Notice of Conversion/Continuation then submitted by them. If the Co-Borrowers does not revoke such Notice, the Banks shall make, convert or continue the Loans, as proposed by the Co-Borrowers, in the amount specified in the applicable notice submitted by the Co-Borrowers, but such Loans shall be made, converted or continued as Base Rate Loans instead of Eurodollar Rate Loans.

4.07 Reserves on Eurodollar Rate Loans. The Co-Borrowers shall pay to each Bank, as long as such Bank shall be required under regulations of the FRB to maintain reserves with respect to liabilities or assets consisting of or including Eurocurrency funds or deposits (currently known as “Eurocurrency liabilities”), additional costs on the unpaid principal amount of each Eurodollar Rate Loan equal to the actual costs of such reserves allocated to such Loan by the Bank (as determined by the Bank in good faith, which determination shall be conclusive), payable on each date on which interest is payable on such Loan, provided the Co-Borrowers shall have received at least 15 days’ prior written notice (with a copy to the Administrative Agent) of such additional interest from the Bank. If a Bank fails to give notice 15 days prior to the relevant Interest Payment Date, such additional interest shall be payable 15 days from receipt of such notice.

4.08 Certificates of Banks. Together with any demand by a Bank for reimbursement or compensation pursuant to this Article IV, such Bank shall provide to the Co-Borrowers (with a copy to the Administrative Agent) a certificate signed by an authorized officer of the Bank (a) describing the event giving rise to such demand, and (b) showing the method and detailed

calculations (which may include any reasonable averaging, attribution or allocation procedures) used by the Bank to determine the amount demanded by the Bank. In calculating the amount of costs, expenses, capital requirements or rate of reduction allocable to the Co-Borrowers, such Bank shall use such reasonable methods as such Bank shall determine. Such calculation and certification shall be conclusive and binding on the Co-Borrowers in the absence of manifest error.

4.09 Substitution of Banks. Upon the receipt by the Co-Borrowers from any Bank (an "Affected Bank") of a claim for compensation under Section 4.04, the Co-Borrowers may: (a) request the Affected Bank to use its best efforts to obtain a replacement bank or financial institution satisfactory to the Co-Borrowers to acquire and assume all or a ratable part of all of such Affected Bank's Loans and Line Portion (a "Replacement Bank"); (b) request one or more of the other Banks to acquire and assume all or part of such Affected Bank's Loans and Line Portion; or (c) designate a Replacement Bank. Any such designation of a Replacement Bank under clause (a) or (c) shall be subject to the prior written consent of the Administrative Agent (which consent shall not be unreasonably withheld).

4.10 Canadian Withholding Taxes. The Co-Borrowers acknowledge that as a result of the transactions contemplated by this Agreement, the Banks may become liable for Canadian withholding taxes. In the event that any Bank becomes liable for such taxes, the Co-Borrowers shall properly reimburse such Bank upon Bank's demand. The Bank's demand shall be accompanied by a certificate in the form described in Section 4.08, and the calculations accompanying the certificate of any Bank shall be conclusive and binding on the Co-Borrowers in the absence of manifest error.

4.11 Survival. The agreements and Obligations of the Co-Borrowers in this Article IV shall survive the payment of all other Obligations.

ARTICLE V

CONDITIONS PRECEDENT

5.01 Conditions to be Satisfied Upon Execution of Agreement. At the time the Banks execute this Agreement, unless otherwise waived by the Banks, the Administrative Agent shall have received all of the following, in form and substance satisfactory to the Administrative Agent and each Bank, and in sufficient copies for each Bank:

(a) Loan Documents. The Loan Documents set forth on Schedule 5.01 and each other document or certificate required to be executed in connection with this Agreement, executed by each party thereto.

(b) Resolutions; Incumbency. Copies of the resolutions of the board of directors of Avista and Avista Capital and the Canadian equivalent thereof for Avista Canada and Copac Management, authorizing the transactions contemplated hereby, certified as of the Closing Date by the Secretary of each such corporation, and certifying the names and true

signatures of the officers of each such corporation authorized to execute, deliver and perform, as applicable, this Agreement, and all other Loan Documents to be delivered by it hereunder;

(c) Organization Documents; Good Standing. The articles or certificate of incorporation and the bylaws of Avista and Avista Capital and the Canadian equivalent thereof for Avista Canada and Copac Management, as in effect on the Closing Date, certified by the Secretary of each such corporation as of the Closing Date, together with a good standing certificate for the Co-Borrowers and the Guarantors from the Secretary of State (or similar, applicable Governmental Authority) of its state or province of incorporation and each state or province where such Co-Borrower or Guarantor is qualified to do business as a foreign corporation, certified as of, or reasonably close to, the Closing Date;

(d) Legal Opinion. Opinions of U.S. and Canadian counsel to the Co-Borrowers and the Guarantors and addressed to the Administrative Agent and the Banks in form and substance acceptable to the Administrative Agent and the Banks;

(e) Payment of Fees. Evidence of payment by the Co-Borrowers of all accrued and unpaid fees (including fees payable to the Agents and the Banks under separate fee letters), costs and expenses to the extent then due and payable on the Closing Date, together with Attorney Costs of the Administrative Agent and Documentation Agent to the extent invoiced prior to or on the Closing Date, plus such additional amounts of Attorney Costs as shall constitute the Administrative Agent's reasonable estimate of Attorney Costs incurred or to be incurred by it through the closing proceedings (provided that such estimate shall not thereafter preclude final settling of accounts between the Co-Borrowers and the Administrative Agent); including any such costs, fees and expenses arising under or referenced in Sections 2.09 and 11.04(a) and all costs of the auditors and consultants retained by the Banks in connection with the Obligations of the Co-Borrowers to the Administrative Agent;

(f) Certificate. A certificate signed by a Responsible Officer of each Co-Borrower, dated as of the Closing Date, stating to the best of such officer's knowledge that:

(i) The representations and warranties contained in Article VI are true and correct on and as of such date, as though made on and as of such date;

(ii) No Default or Event of Default exists; and

(iii) There has not occurred since April 30, 2003, an event or circumstance that has resulted or could reasonably be expected to result in a Material Adverse Effect.

(g) Filings. Evidence that all filings needed to perfect the security interests granted by the Security Agreement have been completed or due provision has been made therefor; and

(h) Other Documents. Such other approvals, opinions, documents or materials as the Administrative Agent or any Bank may request.

5.02 Conditions to be Satisfied Upon Each Credit Extension. Prior to any Credit Extension under this Agreement, the following conditions precedent must be satisfied:

(a) The Administrative Agent shall have received a Notice of Borrowing under Subsection 2.03(a) or 3.02(a) as the case may be;

(b) The representations and warranties contained in Article VI are true and correct on and as of such date, as though made on and as of such date, except to the extent such representations and warranties expressly relate to an earlier date;

(c) No Default or Event of Default exists or would result from the Credit Extension; and

(d) There has not occurred since the last Credit Extension, an event or circumstance that has resulted or could reasonably be expected to result in a Material Adverse Effect.

ARTICLE VI

REPRESENTATIONS AND WARRANTIES

The Co-Borrowers represent and warrant to the Administrative Agent and each Bank that:

6.01 Corporate Existence and Power. Each Co-Borrower and each of its Subsidiaries:

(a) is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation, which in the case of Avista is the State of Washington and in the case of Avista Canada is the Province of Alberta, Canada;

(b) has the power and authority and all governmental licenses, authorizations, consents and approvals to own its assets, carry on its business and to execute, deliver, and perform its Obligations under the Loan Documents;

(c) is duly qualified as a foreign corporation, and is licensed and in good standing under the laws of each jurisdiction where its ownership, lease or operation of property or the conduct of its business requires such qualification or license; and

(d) to the best knowledge of the Co-Borrowers, is in compliance with all Requirements of Law.

6.02 Authorization; No Contravention. The execution, delivery and performance by the Co-Borrowers of this Agreement and each other Loan Document to which either Co-Borrower is party, have been duly authorized by all necessary corporate or partnership action, and do not and will not:

(a) contravene the terms of either Co-Borrower’s Organization Documents;

(b) to the best knowledge of the Co-Borrowers after reasonable due diligence, conflict with or result in any breach or contravention of, or the creation of any Lien under, any document evidencing any Contractual Obligation to which such Co-Borrower is a party or any order, injunction, writ or decree of any Governmental Authority to which such Person or its property is subject; or

(c) to the best knowledge of the Co-Borrowers, violate any Requirement of Law.

6.03 Governmental Authorization. No approval, consent, exemption, authorization, or other action by, or notice to, or filing with, any Governmental Authority is necessary or required in connection with the execution, delivery or performance by, or enforcement against, either Co-Borrower or any of its Subsidiaries of the Agreement or any other Loan Document.

6.04 Binding Effect. This Agreement and each other Loan Document to which any Co-Borrower or any of its Subsidiaries is a party constitute the legal, valid and binding obligations of such Person to the extent it is a party thereto, enforceable against such Person in accordance with their respective terms, except as enforceability may be limited by applicable bankruptcy, insolvency, or similar laws affecting the enforcement of creditors' rights generally or by general principles of equity.

6.05 Litigation. Except as specifically disclosed in Schedule 6.05, there are no actions, suits or proceedings, pending, or to the knowledge of the Co-Borrowers, threatened at law, in equity, in arbitration or before any Governmental Authority, against either Co-Borrower, or any of its Subsidiaries or any of their respective properties which (a) purport to affect or pertain to this Agreement or any other Loan Document, or any of the transactions contemplated hereby or thereby; and no injunction, writ, temporary restraining order or any order of any nature has been issued by any court or other Governmental Authority purporting to enjoin or restrain the execution, delivery or performance of this Agreement or any other Loan Document, or directing that the transactions provided for herein or therein not be consummated as herein or therein provided or (b) if determined adversely, could reasonably be expected to have a Material Adverse Effect.

6.06 No Default. No Default or Event of Default exists or would result from the incurring of any Obligations by the Co-Borrowers. As of the Closing Date, neither of the Co-Borrowers nor any of their Subsidiaries are in default under or with respect to any Contractual Obligation in any respect which, individually or together with all such defaults, could reasonably be expected to have a Material Adverse Effect.

6.07 ERISA Compliance. Except as specifically disclosed in Schedule 6.07:

(a) Each Plan is in compliance in all material respects with the applicable provisions of ERISA, the Code and other federal or state law. Each Plan which is intended to

qualify under Section 401(a) of the Code has received a favorable determination letter from the IRS and to the best knowledge of the Co-Borrowers, nothing has occurred which would cause the loss of such qualification. The Co-Borrowers and each ERISA Affiliate has made all required contributions to any Plan subject to Section 412 of the Code, and no application for a funding waiver or an extension of any amortization period pursuant to Section 412 of the Code has been made with respect to any Plan.

(b) There are no pending or, to the best knowledge of the Co-Borrowers, threatened claims, actions or lawsuits, or action by any Governmental Authority, with respect to any Plan which has resulted or could reasonably be expected to result in a Material Adverse Effect. There has been no prohibited transaction or violation of the fiduciary responsibility rules with respect to any Plan which has resulted or could reasonably be expected to result in a Material Adverse Effect.

(c) (i) To the Co-Borrowers' best knowledge, no ERISA Event has occurred or is reasonably expected to occur; (ii) the present value of all benefit liabilities under each Plan (based on those assumptions used to fund such Plan) did not, as of the last annual valuation date applicable thereto, exceed by more than $25,000,000.00 the value of the assets of such Plan; (iii) neither of the Co-Borrowers nor any ERISA Affiliate has incurred, or reasonably expects to incur, any liability under Title IV of ERISA with respect to any Plan (other than premiums due and not delinquent under Section 4007 of ERISA); (iv) neither of the Co-Borrowers nor any ERISA Affiliate has incurred, or reasonably expects to incur, any liability (and no event has occurred which, with the giving of notice under Section 4219 of ERISA, would result in such liability) under Section 4201 or 4243 of ERISA with respect to a Multiemployer Plan; (v) neither of the Co-Borrowers nor any ERISA Affiliate has engaged in a transaction that could be subject to Section 4069 or 4212(c) of ERISA; and (vi) each Benefit Plan is in compliance in all material respects with the applicable provisions of the Code and other federal or state law.

6.08 Use of Proceeds; Margin Regulations. The proceeds of the Loans are to be used solely for the purposes set forth in and permitted by Section 7.12. Neither of the Co-Borrowers nor any Subsidiary is generally engaged in the business of purchasing or selling Margin Stock or extending credit for the purpose of purchasing or carrying Margin Stock. In no event shall the Co-Borrowers use any portion of the Loan proceeds or any Letter of Credit to invest in one of the Wells Fargo Investment Accounts.

6.09 Title to Properties. Each of the Co-Borrowers and each of their Subsidiaries have good record and marketable title in fee simple to, or valid leasehold interests in, all real property necessary or used in the ordinary conduct of their respective businesses, except for such defects in title as could not, individually or in the aggregate, have a Material Adverse Effect. As of the Closing Date, the property of the Co-Borrowers and their Subsidiaries is subject to no Liens, other than Permitted Liens.

6.10 Taxes. Except as specifically disclosed in Schedule 6.10, each Co-Borrower and its Subsidiaries have filed all Federal and other material tax returns and reports required to be filed, and have paid all Federal and other material taxes, assessments, fees and other governmental charges shown thereon to be due and payable, and have paid all material taxes,

assessments, fees and other governmental charges levied or imposed upon them or their properties, income or assets as due and payable, except those which are being contested in good faith by appropriate proceedings and for which adequate reserves have been provided in accordance with GAAP. There is no proposed tax assessment against either Co-Borrower or any of its Subsidiaries that would, if made, have a Material Adverse Effect.

6.11 Financial Condition.

(a) The unaudited consolidated and consolidating financial statements of Co-Borrowers dated April 30, 2003, and the related consolidated statements of income or operations, shareholders' or partners' equity and cash flows for the fiscal month ended on that date:

(i) were prepared in accordance with GAAP consistently applied throughout the period covered thereby, except that as otherwise expressly noted therein;

(ii) fairly present the financial condition of the Co-Borrowers and their Subsidiaries as of the date thereof and results of operations for the period covered thereby; and

(iii) show all material indebtedness and other liabilities, direct or contingent, of the Co-Borrowers and their consolidated Subsidiaries as of the date thereof, including liabilities for taxes, material commitments and Contingent Obligations.

(b) Since April 30, 2003, there has been no Material Adverse Effect.

6.12 Environmental Matters. The Co-Borrowers conduct in the ordinary course of business a review of the effect of existing Environmental Laws and existing Environmental Claims on their business, operations and properties, and as a result thereof the Co-Borrowers have reasonably concluded that, except as previously specifically disclosed in Schedule 6.12, such Environmental Laws and Environmental Claims could not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect.

6.13 Regulated Entities. Neither of the Co-Borrowers, nor any Person controlling a Co-Borrower, or any of its Subsidiaries, is an "Investment Company" within the meaning of the Investment Company Act of 1940. Except with respect to the regulation of Avista under the Federal Power Act, 16 U.S.C. §§ 791a *et seq*., neither of the Co-Borrowers is subject to regulation under any Federal or state statute or regulation limiting Co-Borrowers' ability to incur Indebtedness. Neither of the Co-Borrowers is now regulated as a "natural gas company" under the Natural Gas Act, 15 U.S.C. §§ 717 *et seq*, or as a "public-utility company" under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* Avista is subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") as a public utility under the Federal Power Act. Pursuant to such jurisdiction Avista is required by FERC to (a) have a rate schedule on file with FERC, which rate schedule states that sales under the rate schedule shall be made at rates established by agreement between purchasers and Avista, and (b) file quarterly reports with FERC concerning sales of power pursuant to the rate schedule. Avista is authorized by FERC, pursuant to Section 204 of the Federal Power Act, 16 U.S.C. § 824c, to issue securities

and assume obligations, including the Obligations under this Agreement, provided that such issue is for some lawful object, within the corporate purposes of Avista, compatible with the public interests, and reasonably necessary or appropriate for such purposes. FERC has waived compliance by Avista with, or granted Avista authority under, other Federal Power Act regulations pertaining to public utilities.

6.14 No Burdensome Restrictions. Neither of the Co-Borrowers nor any of their Subsidiaries is a party to or bound by any Contractual Obligation, or subject to any restriction in any Organization Document, or any Requirement of Law, which could reasonably be expected to have a Material Adverse Effect.

6.15 Copyrights, Patents, Trademarks and Licenses, Etc. To the Co-Borrowers' best knowledge, the Co-Borrowers or their Subsidiaries own or are licensed or otherwise have the right to use all of the patents, trademarks, service marks, trade names, copyrights, contractual franchises, authorizations and other rights that are reasonably necessary for the operation of their respective businesses, without conflict with the rights of any other Person. To the knowledge of the Co-Borrowers, no slogan or other advertising device, product, process, method, substance, part or other material now employed, or now contemplated to be employed, by any Co-Borrower or any Subsidiary infringes upon any rights held by any other Person. Except as specifically disclosed in Schedule 6.05, no claim or litigation regarding any of the foregoing is pending or threatened, and no patent, invention, device, application, principle or any statute, law, rule, regulation, standard or code is pending or, to the knowledge of the Co-Borrowers, proposed.

6.16 Subsidiaries. The Co-Borrowers have no Subsidiaries other than those specifically disclosed in part (a) of Schedule 6.16 hereto and have no equity investments in any other corporation or entity other than those specifically disclosed in part (b) of Schedule 6.16.

6.17 Insurance. Except as specifically disclosed in Schedule 6.17, the properties of each Co-Borrower and its Subsidiaries are insured with financially sound and reputable insurance companies not Affiliates of any Co-Borrower, in such amounts, with such deductibles and covering such risks as are customarily carried by companies engaged in similar businesses and owning similar properties in localities where such Co-Borrower or such Subsidiary operates.

6.18 Full Disclosure. To the Co-Borrowers' best knowledge, none of the representations or warranties made by the Co-Borrowers or any of their Subsidiaries in the Loan Documents as of the date such representations and warranties are made or deemed made, and none of the statements contained in any exhibit, report, statement or certificate furnished by or on behalf of the Co-Borrowers or any of their Subsidiaries in connection with the Loan Documents (including the offering and disclosure materials delivered by or on behalf of the Co-Borrowers to the Banks prior to the Closing Date), contains any untrue statement of a material fact or omits any material fact required to be stated therein or necessary to make the statements made therein, in light of the circumstances under which they are made, not misleading as of the time when made or delivered.

ARTICLE VII

AFFIRMATIVE COVENANTS

So long as any Bank shall be continuing to consider making Revolving Loans or Issuing Letters of Credit hereunder, or any Loan or other Obligation shall remain unpaid or unsatisfied, or any Letter of Credit shall remain outstanding:

7.01 Financial Statements. The Co-Borrowers shall deliver to the Banks, in form and detail satisfactory to the Banks:

(a) as soon as available, but not later than 120 days after the end of each fiscal year, a copy of the audited financial statements to include a balance sheet as at the end of such year on a consolidated basis for the Co-Borrowers and their Affiliates and Subsidiaries, with consolidating schedules and the related statements of income or operations, shareholders' equity and cash flows for such year on a consolidated basis for the Co-Borrowers and their Affiliates and Subsidiaries, setting forth in each case in comparative form the figures for the previous fiscal year, and accompanied by the opinion of a nationally-recognized independent public accounting firm ("Independent Auditor") which report shall state that such financial statements present fairly the financial position for the periods indicated in conformity with GAAP applied on a basis consistent with prior years. Such financial statements and opinion shall (i) be accompanied by a "negative assurance letter" with respect to such financial statement stating that "in connection with its audit, nothing came to its attention that caused the Independent Auditor to believe that the Co-Borrowers were not in compliance with the covenants of this Agreement insofar as they related to financial and accounting matters," and (ii) not contain a going concern or scope of audit qualification and such opinion in all respects must otherwise be acceptable to the Banks in their discretion. At such time, the Co-Borrowers shall also deliver a report prepared by the Co-Borrowers and certified by a Responsible Officer of each Co-Borrower reconciling the calculations made on an Economic Basis with GAAP;

(b) as soon as available, but not later than forty-five (45) days after the end of each month, consolidated and consolidating Co-Borrowers-prepared financial statements for the Co-Borrowers in form acceptable to Banks, to be accompanied by a report prepared by the Co-Borrowers reconciling the calculations made on an Economic Basis with GAAP.

(c) as soon as available, but not later than sixty (60) days after the end of each calendar quarter and calendar year end, unaudited financial statements for Avista Capital in a form acceptable to Banks; and

(d) as soon as available, but not later than one hundred twenty (120) days after the end of each calendar year, audited financial statements for Avista Capital in a form acceptable to Banks, and accompanied by the opinion of the Independent Auditor referred to in Subsection 7.01(a) above, in form acceptable to Banks.

7.02 Certificates; Other Information. The Co-Borrowers shall furnish to the Administrative Agent and the Banks:

(a) concurrently with the delivery of the financial statements referred to in Subsections 7.01(a) and (b), a Compliance Certificate executed by a Responsible Officer of the Co-Borrowers;

(b) as of the last day of each month and the fifteenth day of each month (or, if such day is a weekend or a holiday, the Business Day immediately following such day), delivered within three Business Days of the reporting date, and upon each request for utilization of the Borrowing Base Line if there are no outstanding amounts under the Borrowing Base Line on the date of such request, a Borrowing Base Report, in each case executed by a Responsible Officer of the Co-Borrowers, provided, that upon the occurrence of the amount of the difference between (i) the sum of the amounts listed in subsection (b) of the definition of “Borrowing Base Cap” and (ii) total outstandings under the Borrowing Base Line being less than $25,000,000, a Borrowing Base Report shall be required weekly, on Wednesday of each week as of Friday of the preceding week and on the 6th calendar day of each month as of the last calendar day of the preceding month, in each case executed by a Responsible Officer of the Co-Borrowers (provided the Co-Borrowers shall have no duty to deliver two Borrowing Base Reports in the same calendar week and if as a result of month end two such reports would be due during the same calendar week, the Co-Borrowers shall not be required to deliver a weekly report for the last Friday of such month, provided further that the Co-Borrower shall have no duty to deliver a Borrowing Base Report if on the reporting date under this subsection (b) there has been no utilization of the Borrowing Base Line).

(c) as of the last day of each month, delivered within three Business Days of the reporting date, a Value at Risk Report, certified by a Responsible Officer of the Co-Borrowers in the form attached hereto as Exhibit F, except that if there has been utilization of the Borrowing Base Line within the first fifteen days of such month, a Value at Risk Report as of such fifteenth day shall be furnished to the Administrative Agent within three Business Days of such day;

(d) on Wednesday of each week, a Volumetric Position Report in form acceptable to the Banks, as of Friday of the preceding week, executed by a Responsible Officer of the Co-Borrowers;

(e) on Wednesday of each week, a Mark-to-Market profit and loss statement on a consolidated basis for the Co-Borrowers, in form acceptable to Banks, as of the preceding Friday, certified by a Responsible Officer of the Co-Borrowers; provided, however, Co-Borrowers shall provide such statements more frequently upon request of Banks (The Mark-to-Market profit and loss statement delivered to the Banks on Wednesday of each week, as of Friday of the preceding week, shall include an estimate of Net Working Capital (as reported on the most recent Compliance Certificate) adjusted for (i) Mark-to-Market gains and losses related to positions with a term of less than one year, (ii) material capital expenditures, and (iii) material capital contributions and distributions);

(f) promptly when available, such additional information regarding the business, financial or corporate affairs of the Co-Borrowers or any Subsidiary as the Administrative Agent, at the request of any Bank, may from time to time reasonably request;

(g) within five (5) days after the end of each calendar quarter, a quarterly report of natural gas inventory storage locations at each quarter end;

(h) on or before the tenth (10th) Business Day of each month, a Stress Test Report as of the end of the immediately preceding calendar month, in form and substance satisfactory to Banks, setting forth the potential calculated losses evidenced by a stress test of the Co-Borrowers' (i) short-term book, plus (ii) the long-term book using the greatest daily price percentage upward and/or downward movement derived from the historical daily price fluctuations for the period ending on the date of such calculation, multiplied by 1.5 and then applied to the Co-Borrower's short-term and long-term books; Co-Borrowers may request that the Banks agree to substitute a different Stress Test in lieu of the forgoing test, but the Banks may accept or reject such substitute test in their sole discretion; and

(i) concurrently with the delivery of the Borrowing Base Report referred to in Subsection 7.02(a), a report, in form and substance satisfactory to the Banks, of the potential offsets from out-of-the-money forward positions with counterparties whose Accounts or Exchange Receivables are included in the calculation of the Borrowing Base Cap.

7.03 Notices. The Co-Borrowers shall promptly notify the Administrative Agent and each Bank:

(a) of the occurrence of any Default or Event of Default, and of the occurrence or existence of any event or circumstance that could reasonably be expected to become a Default or Event of Default;

(b) of the occurrence of any event which could reasonably be expected to cause a material impairment of the Collateral used to calculate the Borrowing Base Cap;

(c) of the occurrence of any event which could reasonably be expected to cause a Material Adverse Effect, including (i) breach or non-performance of, or any default under, a material Contractual Obligation of either Co-Borrower or any Subsidiary; (ii) any material dispute, litigation, investigation, proceeding or suspension between a Co-Borrower or any Subsidiary and any Governmental Authority; or (iii) the commencement of, or any material development in, any litigation or proceeding affecting a Co-Borrower or any Subsidiary, including pursuant to any applicable Environmental Laws;

(d) of the occurrence of any of the following events affecting a Co-Borrower or any ERISA Affiliate (but in no event more than 10 days after such Co-Borrower receives notice or becomes aware of such event), and deliver to the Administrative Agent and each Bank a copy of any notice with respect to such event that is filed with a Governmental Authority and any notice delivered by a Governmental Authority to such Co-Borrower or any ERISA Affiliate with respect to such event:

(i) an ERISA Event;

(ii) the present value of all benefit liabilities under each Plan (based on those assumptions used to fund such Plan), as of the last annual valuation date applicable thereto, exceeds by more than $5,000,000.00 the value of the assets of such Plan;

(iii) the adoption of, or the commencement of contributions to, any Plan subject to Section 412 of the Code by the Co-Borrowers or any ERISA Affiliate, other than Plans in existence on the date of this Agreement;

(iv) the adoption of any amendment to a Plan subject to Section 412 of the Code, if such amendment results in (a) a material increase in contributions or (b) the present value of all benefit liabilities under each Plan (based on those assumptions used to fund such Plan), as of the last annual valuation date applicable thereto, exceeding by more than $5,000,000.00 the value of the assets of such Plan, other than amendments required to maintain a Plan's tax qualified status under Section 401(a) of the Code;

(e) of any material change in accounting policies or financial reporting practices by either Co-Borrower;

(f) of any intended relocation of natural gas inventory or any intended new location of natural gas inventory owned by a Co-Borrower, at least ten (10) Business Days prior to the date such inventory is to be stored at such location; and

(g) of any amounts deposited in the Wells Fargo Collateral Account pursuant to the Wells Fargo FX Documents.

Each notice under this Section shall be accompanied by a written statement by a Responsible Officer of the Co-Borrowers setting forth details of the occurrence referred to therein, and stating what action the Co-Borrowers or any affected Subsidiary proposes to take with respect thereto and at what time. Each notice under Subsection 7.03(a) shall describe with particularity any and all clauses or provisions of this Agreement or other Loan Document that have been (or reasonably could be expected to be) breached or violated as therein provided.

7.04 Preservation of Corporate Existence, Etc. The Co-Borrowers shall, and shall cause each of their Subsidiaries to:

(a) preserve and maintain in full force and effect its corporate or partnership existence and good standing under the laws of its state or jurisdiction of incorporation or organization;

(b) preserve and maintain in full force and effect all governmental rights, privileges, qualifications, permits, licenses and franchises necessary or desirable in the normal conduct of its business;

(c) use reasonable efforts, in the ordinary course of business, to preserve its business organization and goodwill; and

(d) preserve or renew all of its registered patents, trademarks, trade names and service marks, the non-preservation of which could reasonably be expected to have a Material Adverse Effect.

7.05 Maintenance of Property. Each of the Co-Borrowers shall maintain, and shall cause each of its Subsidiaries to maintain, and preserve all its property which is used or useful in its business in good working order and condition, ordinary wear and tear excepted and make all necessary repairs thereto and renewals and replacements thereof except in any case where the failure to do so could not reasonably be expected to have a Material Adverse Effect.

7.06 Insurance. Each of the Co-Borrowers shall maintain, and shall cause each of its Subsidiaries to maintain, with financially sound and reputable independent insurers, insurance with respect to its properties and business against loss or damage of the kinds customarily insured against by Persons engaged in the same or similar business, of such types and in such amounts as are customarily carried under similar circumstances by such other Persons, including, without limitation, marine cargo insurance, if appropriate. Administrative Agent, for the benefit of the Banks, shall be named as an additional insured and loss payee under all such polices, without liability for premiums or club calls.

7.07 Payment of Obligations. Each of the Co-Borrowers shall, and shall cause each of its Subsidiaries and Affiliates to, pay and discharge as the same shall become due and payable, all their respective obligations and liabilities, including:

(a) all tax liabilities, assessments and governmental charges or levies upon it or its properties or assets, unless the same are being contested in good faith by appropriate proceedings and adequate reserves in accordance with GAAP are being maintained by such Co-Borrower or such Subsidiary;

(b) all lawful claims which, if unpaid, would by law become a Lien upon its property unless the same are being contested in good faith by appropriate proceedings and adequate reserves in accordance with GAAP are being maintained by such Co-Borrower or Subsidiary, and provided that at such time the claim becomes a Lien (other than a lis pendens notice), it shall be promptly paid; and

(c) all indebtedness, as and when due and payable, but subject to any subordination provisions contained in any instrument or agreement evidencing such Indebtedness.

7.08 Compliance with Laws. Each of the Co-Borrowers shall comply, and shall cause each of its Subsidiaries and Affiliates to comply, with all Requirements of Law of any Governmental Authority having jurisdiction over it or its business (including the Federal Fair Labor Standards Act).

7.09 Compliance with ERISA. Each of the Co-Borrowers shall, and shall cause each of its ERISA Affiliates to: (a) maintain each Plan in material compliance with the applicable provisions of ERISA, the Code and other applicable federal or state law; (b) cause each Plan which is qualified under Section 401(a) of the Code to maintain such qualification; and (c) make all required contributions to any Plan subject to Section 412 of the Code.

7.10 Inspection of Property and Books and Records. Each of the Co-Borrowers shall maintain and shall cause each of its Subsidiaries to maintain proper books of record and account, in which full, true and correct entries in conformity with GAAP consistently applied shall be made of all financial transactions and matters involving the assets and business of such Co-Borrower and Subsidiary. Each Co-Borrower shall permit, and shall cause each of its Subsidiaries to permit representatives and independent contractors of the Administrative Agent or any Bank to visit and inspect any of their respective properties, to examine their respective corporate, financial and operating records, and make copies thereof or abstracts therefrom, and to discuss their respective affairs, finances and accounts with their respective directors, officers, and independent public accountants, all at the expense of the Administrative Agent or Bank causing such inspection and at such reasonable times during normal business hours and as often as may be reasonably desired, upon reasonable advance notice to the Co-Borrowers; provided, however, when an Event of Default exists the Administrative Agent or any Bank may do any of the foregoing at the expense of the Co-Borrowers at any time during normal business hours and without advance notice.

7.11 Environmental Laws. Each of the Co-Borrowers shall, and shall cause each of its Subsidiaries to, conduct its operations and keep and maintain its property in compliance in all material respects with all Environmental Laws.

7.12 Use of Proceeds. Each of the Co-Borrowers shall use the proceeds of the Loans for the uses described in this Agreement and not in contravention of any Requirement of Law or of any Loan Document restrictions on use of loan proceeds. The Co-Borrowers shall not use the proceeds of the Loan or any Letter of Credit to acquire, directly or indirectly, any Margin Stock.

7.13 Borrowing Base Audit. At such times as Administrative Agent deems advisable, the Co-Borrowers will allow Administrative Agent or an entity satisfactory to Administrative Agent to conduct a thorough examination of the Collateral used to calculate the Borrowing Base Cap, and the Co-Borrowers will fully cooperate in such examination. The Co-Borrowers shall pay the reasonable costs and expenses related to the examinations.

7.14 Risk Management Procedures Audit. At such times as Administrative Agent deems advisable, the Co-Borrowers will allow Administrative Agent or an entity satisfactory to Administrative Agent to conduct a thorough examination of the Co-Borrowers' risk management procedures, and the Co-Borrowers will fully cooperate in such examination. Such examinations shall not exceed two (2) per calendar year; provided, however, at any time the Administrative Agent or any Bank deems it necessary, at its option, the Administrative Agent, any Bank or a third party designated by the Administrative Agent may conduct additional examinations. The Co-Borrowers shall pay the reasonable costs and expenses related to the examinations.

7.15 Payments to Bank Blocked Accounts.

(a) The Co-Borrowers promptly, and from time to time, shall notify all Account Debtors under all of its Accounts to make all payments under such Accounts to the Bank Blocked Accounts or the Lockbox and shall provide Banks with reasonable evidence of such notification. In the event that any Account Debtor does not make any payment directly to a Bank Blocked Account or the Lockbox, such Co-Borrower shall promptly deposit such amounts into its Bank Blocked Account or Lockbox.

(b) Co-Borrowers may transfer funds from the Bank Blocked Accounts into an Operating Account, a Wells Fargo Investment Account, or a Paribas Investment Account, until such time as Wells Fargo receives an Activation Notice pursuant to the Override Agreement. Prior to the receipt by Wells Fargo of such an Activation Notice, Co-Borrowers may transfer funds among such Accounts and may make disbursements from the Operating Accounts unless such disbursement is otherwise restricted by the provision of this Agreement.

(c) The Collateral Agent may, in its sole discretion or shall at the discretion of any Bank, deliver an Activation Notice to Wells Fargo with a copy to the Co-Borrowers. During an Activation Period, in order to request a transfer from the Bank Blocked Accounts, Co-Borrowers shall utilize the form attached hereto as Exhibit I, which may be sent by facsimile to the Collateral Agent. During an Activation Period the Collateral Agent may from time to time approve a request of the Co-Borrowers to transfer proceeds from the Bank Blocked Accounts into an Operating Account, a Wells Fargo Investment Account, or a Paribas Investment Account, and may from time to time approve a request of the Co-Borrowers to wire transfer funds from the Operating Accounts and to pay checks presented to the Operating Accounts (including any such approvals conducted by electronic means satisfactory to the Collateral Agent). However, during an Activation Period, the Collateral Agent has absolutely no duty to approve any such request to transfer funds into any Operating Account, Wells Fargo Investment Account or Paribas Investment Account or any such wire transfer or payment of any such check, and at any time may refuse to approve any such request to transfer funds into any Operating Account, Wells Fargo Investment Account or Paribas Investment Account or to wire transfer funds out of any Operating Account or to pay any such check presented against any Operating Account, in each case until all Obligations have been satisfied.

(d) During an Activation Period, and provided there exists an Event of Default at such time, the Collateral Agent at any time may apply amounts contained in the Bank Blocked Accounts, the Operating Accounts, the Wells Fargo Investment Accounts or the Paribas Investment Accounts toward satisfaction of the Obligations in accordance with the requirements of this Agreement. The Co-Borrowers and each other Bank other than BNP Paribas acknowledge and agree that during an Activation Period the Bank Blocked Accounts, the Operating Accounts, the Paribas Investment Accounts and the Lockbox are under the exclusive dominion and control of the Collateral Agent. The Co-Borrowers further acknowledge and agree that although the Collateral Agent may from time to time during an Activation Period approve a request to transfer funds into one of the Wells Fargo Investment Accounts, the Collateral Agent has no duty to approve any such request and to the extent of any transfer, all amounts in the Wells Fargo

Investment Accounts are and shall remain during an Activation Period in the exclusive dominion and control of the Collateral Agent.

7.16 Compliance with FERC. Each Co-Borrower agrees to comply with all requirements of the FERC applicable to such Co-Borrower. Each Co-Borrower further agrees to (a) promptly notify the Banks of any request received from FERC for information regarding Avista's business operations or any other material development involving Avista's relationship with FERC, (b) keep the Banks informed as to such matters between such Co-Borrower and FERC as the Banks may request and (c) to make available to the Banks for inspection copies of all material correspondence between such Co-Borrower and FERC.

7.17 [Intentionally Deleted].

7.18 Estimate of Net Working Capital. The Co-Borrowers shall maintain on a bi-weekly basis an estimate of Net Working Capital and such estimate shall not be less than the minimum amount set forth on Subsection 8.12(a). Such estimate shall be calculated based upon the Net Working Capital (as reported on the most recent Compliance Certificate) adjusted for (a) Mark-to-Market gains and losses related to positions with a term of less than one year, (b) material capital expenditures, and (c) material capital contributions and distributions.

7.19 Further Information. Co-Borrowers shall deliver to Administrative Agent, promptly upon sending or receipt, copies of any and all management letters and correspondence relating to management letters, sent or received by Co-Borrowers to or from the Independent Auditor.

ARTICLE VIII

NEGATIVE COVENANTS

So long as any Loan or other Obligation shall remain unpaid or unsatisfied, or any Letter of Credit shall remain outstanding, unless the Banks waive compliance in writing:

8.01 Limitation on Liens. The Co-Borrowers shall not, and shall not suffer or permit any Subsidiary to, directly or indirectly, make, create, incur, assume or suffer to exist any Lien upon or with respect to any part of its property, whether now owned or hereafter acquired, other than the following ("Permitted Liens"):

(a) any Lien existing on property of a Co-Borrower or any of its Subsidiaries on the Closing Date and set forth in Schedule 8.01 securing Indebtedness outstanding on such date;

(b) any Lien created under any Loan Document;

(c) Liens for taxes, fees, assessments or other governmental charges which are not delinquent or remain payable without penalty, or to the extent that non-payment thereof is

permitted by Section 7.07, provided that no notice of lien has been filed or recorded under the Code;

(d) carriers', warehousemen's, mechanics', landlords', materialmen's, repairmen's or other similar Liens arising in the ordinary course of business which are not delinquent or remain payable without penalty and, with respect to any such warehousemen's or landlord's lien, such liens only secure accrued rental charges;

(e) Liens (other than any Lien imposed by ERISA) consisting of pledges or deposits required in the ordinary course of business in connection with workers' compensation, unemployment insurance and other social security legislation;

(f) Liens on the property of the Co-Borrowers or their Subsidiaries securing (i) the non-delinquent performance of bids, trade contracts (other than for borrowed money), leases, statutory obligations, (ii) contingent obligations on surety and appeal bonds, and (iii) other non-delinquent obligations of a like nature; in each case, incurred in the ordinary course of business, provided all such Liens in the aggregate would not (even if enforced) cause a Material Adverse Effect;

(g) Liens consisting of judgment or judicial attachment liens, provided that the enforcement of such Liens is effectively stayed and all such unstayed liens in the aggregate at any time outstanding for the Co-Borrowers and their Subsidiaries do not exceed $100,000.00;

(h) easements, rights-of-way, restrictions and other similar encumbrances incurred in the ordinary course of business which, in the aggregate, are not substantial in amount, and which do not in any case materially interfere with the ordinary conduct of the business of the Co-Borrowers and their Subsidiaries;

(i) purchase money security interests (other than capital leases) on any property acquired or held by a Co-Borrower or its Subsidiaries in the ordinary course of business, securing Indebtedness incurred or assumed for the purpose of financing all or any part of the cost of acquiring such property; provided that (i) any such Lien attaches to such property concurrently with or within 20 days after the acquisition thereof, (ii) such Lien attaches solely to the property so acquired in such transaction, (iii) the principal amount of the debt secured thereby does not exceed 100% of the cost of such property, and (iv) the principal amount of the Indebtedness secured by any and all such purchase money security interests shall not at any time exceed $100,000.00;

(j) Liens of interest owners, including without limitation, Liens arising as would be defined in Texas Bus. & Com. Code Section 9.319, comparable laws of the states of Oklahoma, Kansas, Wyoming or New Mexico, or other comparable law; and

(k) The Lien permitted pursuant to that certain Security Agreement: Rights to Payment dated as of October 31, 2002 of Avista in favor of Wells Fargo.

8.02 Consolidations and Mergers. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, merge, consolidate with or into, or convey, transfer, lease or otherwise dispose of (whether in one transaction or in a series of transactions) all or substantially all of its assets (whether now owned or hereafter acquired) to or in favor of any Person.

8.03 Limitation on Indebtedness. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, create, incur, assume, suffer to exist, or otherwise become or remain directly or indirectly liable with respect to, any Indebtedness, except:

(a) Indebtedness incurred pursuant to or in accordance with, this Agreement;

(b) Indebtedness consisting of trade payables in the ordinary course of business;

(c) Indebtedness existing on the Closing Date, and described on Schedule 8.01;

(d) Indebtedness in respect of purchase money security interests permitted by Section 8.01 hereof;

(e) Indebtedness in respect of Contingent Obligations permitted by Section 8.06 hereof; and

(f) the Eligible Subordinated Debt.

8.04 Transactions with Affiliates. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, enter into any transaction with any Affiliate of a Co-Borrower, except upon fair and reasonable terms no less favorable to such Co-Borrower or such Subsidiary than would obtain in a comparable arm's-length transaction with a Person not an Affiliate of a Co-Borrower or such Subsidiary.

8.05 Use of Proceeds. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, use any portion of the Loan proceeds or any Letter of Credit, directly or indirectly, (a) to purchase or carry Margin Stock, (b) to repay or otherwise refinance indebtedness of a Co-Borrower or others incurred to purchase or carry Margin Stock, (c) to extend credit for the purpose of purchasing or carrying any Margin Stock, (d) to acquire any security in any transaction that is subject to Section 13 or 14 of the Exchange Act; or (e) to invest in the Wells Fargo Investment Accounts.

8.06 Contingent Obligations. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, create, incur, assume or suffer to exist any Contingent Obligations except:

(a) endorsements for collection or deposit in the ordinary course of business;

(b) swap contracts entered into in the ordinary course of business as bona fide hedging transactions; and

(c) Contingent Obligations of the Co-Borrowers and their Subsidiaries existing as of the Closing Date and described on Schedule 8.06.

8.07 Restricted Payments. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, declare or make any dividend payment or other distribution of assets, properties, cash, rights, obligations or securities on account of any shares of any class of its capital stock, or purchase, redeem or otherwise acquire for value any shares of its capital stock or any warrants, rights or options to acquire such shares, now or hereafter outstanding; except that the Co-Borrowers may:

(a) declare and make dividend payments or other distributions payable solely in their common stock;

(b) purchase, redeem or otherwise acquire shares of their common stock or warrants or options to acquire any such shares with the proceeds received from the substantially concurrent issue of new shares of their common stock; and

(c) declare and make dividend payments to Avista Capital provided, that no such dividend shall be declared or paid unless, immediately after giving effect to such proposed action, no Default or Event of Default would exist, provided, further, that upon each payment of a dividend, the Co-Borrowers execute and deliver to the Banks a Notification of Dividend Payment, substantially in the form attached hereto as Schedule 8.07(c).

8.08 ERISA. The Co-Borrowers shall not, nor suffer or permit any of their ERISA Affiliates to: (a) engage in a prohibited transaction or violation of the fiduciary responsibility rules with respect to any Plan; or (b) engage in a transaction that could be subject to Section 4069 or 4212(c) of ERISA.

8.09 Change in Business. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, engage in any line of business or trading strategies, policies and procedures other than those outlined on Schedule 8.09.

8.10 Accounting Changes. The Co-Borrowers shall not, nor suffer or permit any of their Subsidiaries to, make any significant change in accounting treatment or reporting practices, except as required by GAAP, or change the fiscal year of such Co-Borrower or of any Subsidiary without the prior written consent of the Banks.

8.11 Value at Risk of Open Positions.

(a) At no time will the Co-Borrowers allow the total Value at Risk of their Open Positions to exceed $5,200,000.00.

(b) At no time will the Co-Borrowers allow the Value at Risk of their Open Positions in electricity only to exceed $4,500,000.00.

(c) At no time will the Co-Borrowers allow the Value at Risk of their Open Positions in natural gas only to exceed $3,600,000.00.

8.12 Consolidated Financial Covenants. The Co-Borrowers will, at all times, observe the following financial covenants, on a consolidated basis:

(a) Minimum Net Working Capital in an amount not less than $15,600,000.00, provided however if there are no amounts outstanding under the Borrowing Base Line, for purposes of this Subsection 8.12(a) "Net Working Capital" shall be defined to include any cash securing Letters of Credit issued under the Collateralized L/C Line;

(b) Net Working Capital in an amount required to support the Elected Line Cap elected by the Co-Borrowers;

(c) Maximum ratio of total liabilities, including without limitation, energy commodity liabilities, (adjusted by netting Mark-to-Market assets and liabilities from the same counter parties), plus Letters of Credit not supporting balance sheet liabilities to Net Worth of 6:1; and

(d) Minimum Net Worth in an amount not less than $130,000,000.00,

provided that, in no event will the Co-Borrowers' Net Working Capital or Net Worth calculated in accordance with GAAP be less than zero.

8.13 Risk Management Policy. The Co-Borrowers (a) will not materially change their revised risk management policies or the volumetric limits reflected on Exhibit H attached hereto, without the prior written consent of Administrative Agent and the Banks, and (b) will comply with such risk management policies in all material respects and with the volumetric limits reflected on Exhibit H attached hereto in all instances.

8.14 Hourly and Daily Trading Expense. The Co-Borrowers will not permit, at any time, the exposure related to hourly and daily trading of electricity to exceed the lesser of (i) 3 1/2% of Co-Borrowers' last reported estimated Net Working Capital, or (ii) $1,750,000.00.

8.15 Loans and Investments. Neither Co-Borrower shall purchase or acquire, or suffer or permit any Subsidiary to purchase or acquire, or make any commitment therefor, any capital stock, equity interest, or any obligations or other securities of, or any interest in, any Person, or make or commit to make any Acquisitions, or make or commit to make any advance, loan, extension of credit or capital contribution to or any other investment in, any Person including Avista Corporation, Avista Capital or any other Affiliate of either Co-Borrower, except for:

(a) investments in cash equivalents held directly by the Co-Borrowers and Marketable Securities;

(b) extensions of credit in the nature of accounts receivable or notes receivable arising from the sale or lease of goods or services in the ordinary course of business;

(c) advances, loans or extensions of credit to Avista Capital provided the following conditions are satisfied at the time such advance, loan or extension of credit is made:

(i) The tenor of such advance, loan or extension of credit is 90 days or less;

(ii) Avista Capital certifies to the Co-Borrowers and the Administrative Agent that it has liquidity sufficient to repay the loan immediately upon demand by the Co-Borrowers;

(iii) The aggregate advances, loans or extensions of credit do not exceed 30% of the Co-Borrowers' Net Worth;

(iv) No Default or Event of Default exists;

(v) The instrument or other evidence of Avista Capital's indebtedness to the Co-Borrowers provides that if there is a Default or Event of Default hereunder, such indebtedness shall become immediately due and payable; and

(vi) The aggregate advances, loans and extensions of credit together with the purchases of Avista Corporation's debt securities permitted under Subsection (d) below do not exceed 50% of the Co-Borrowers' Net Worth; and

(d) purchases of debt securities of Avista Corporation provided the following conditions are satisfied at the time such purchase is made:

(i) the debt security being purchased will be treated as a long-term asset on the books of the Co-Borrowers;

(ii) The aggregate purchased debt securities do not exceed 30% of the Co-Borrowers' Net Worth;

(iii) No Default or Event of Default exists;

(iv) The aggregate purchased debt securities together with the advances, loans and extensions of credit permitted under Subsection (c) above do not exceed 50% of the Co-Borrowers' Net Worth; and

(v) Upon delivery to the Collateral Agent of the debt securities being purchased (which delivery shall occur within five (5) Business Days of the purchase), or other appropriate arrangements, the Collateral Agent will have a first priority perfected security interest in such debt securities.

Provided that if there is a Default or Event of Default hereunder, the Administrative Agent may demand that the Co-Borrowers sell the purchased debt securities.

8.16 Certification. Upon the making of any advance, loan or extension of credit to Avista Capital under Subsection 8.15(c) or the purchase of debt securities of Avista Corporation under Subsection 8.15(d), the Co-Borrowers shall promptly furnish a certification to the Administrative Agent certifying that the conditions of Subsection 8.15(c) or 8.15(d), as the case may be, have been satisfied.

8.17 Change of Management. Co-Borrowers shall not permit any Change of Management. For purposes of this Section 8.17, "Change of Management" shall mean that any of Dennis Vermillion, Gary Ely, Michael D'Arienzo or David Dickson cease to occupy their present positions with the Co-Borrowers, and the Co-Borrowers shall have failed to replace such individuals with persons possessing similar expertise (reasonably satisfactory to the Banks) within ninety (90) days of such event.

8.18 Stress Test Short Term Book/Long Term Book. At no time will either Co-Borrower allow the results of the stress test, using the method described in Subsection 7.02(h) and evidenced by the stress test report applied to its short-term book, plus the dollar amount of the long-term stress test result that is over and above the long-term book value recorded on the balance sheet, to exceed, for two consecutive calendar months, the lesser of (i) 90% of the Adjusted Net Working Capital required under Section 8.12 hereof, or (ii) $50,000,000.00.

8.19 Posted Collateral Investments. At no time will either Co-Borrower invest any Posted Collateral in any Marketable Securities with tenors beyond 90 days.

8.20 Wells Fargo FX Documents. Co-Borrower shall not permit any material amendment of the Wells Fargo FX Documents.

ARTICLE IX

EVENTS OF DEFAULT

9.01 Event of Default. Any of the following shall constitute an "Event of Default":

(a) Non-Payment. Either Co-Borrower fails to pay any amount payable hereunder or under any other Loan Document when due; or

(b) Representation or Warranty. Any representation or warranty made or deemed made herein, in any other Loan Document, or which is contained in any certificate, document or financial or other statement by a Co-Borrower or Guarantor, or any Responsible Officer thereof furnished at any time under this Agreement, or in or under any other Loan Document, is incorrect or incomplete in any respect on or as of the date made or deemed made; or

(c) Covenant Defaults. Either Co-Borrower fails to perform or observe any other term, covenant or agreement contained in any of the Loan Documents; or

(d) Cross-Default. Either Co-Borrower or any Subsidiary of a Co-Borrower (i) fails to make any payment in respect of any Indebtedness or Contingent Obligation having an aggregate principal amount (including undrawn committed or available amounts and including amounts owing to all creditors under any combined or syndicated credit arrangement) of more than $100,000.00 when due (whether by scheduled maturity, required prepayment, acceleration, demand, or otherwise); or (ii) fails to perform or observe any other material condition or covenant, or any other event shall occur or condition exist, under any agreement or instrument relating to any such Indebtedness or Contingent Obligation, if, after expiration of any grace or cure period therein provided, the effect of such failure, event or condition is to cause, or to permit the holder or holders of such Indebtedness or beneficiary or beneficiaries of such Indebtedness (or a trustee or agent on behalf of such holder or holders or beneficiary or beneficiaries) to cause such Indebtedness to be declared to be due and payable prior to its stated maturity, or such Contingent Obligation to become payable or cash collateral in respect thereof to be demanded; or

(e) Insolvency; Voluntary Proceedings. Either Co-Borrower or any Subsidiary of a Co-Borrower (i) ceases or fails to be solvent, or generally fails to pay, or admits in writing its inability to pay, its debts as they become due, whether at stated maturity or otherwise; (ii) commences any Insolvency Proceeding with respect to itself; or (iii) takes any action to effectuate or authorize any of the foregoing; or

(f) Involuntary Proceedings. (i) Any involuntary Insolvency Proceeding is commenced or filed against either Co-Borrower or any Subsidiary of a Co-Borrower, or any writ, judgment, warrant of attachment, execution or similar process, is issued or levied against a substantial part of a Co-Borrower or any Subsidiary or any of either Co-Borrower's properties, and any such proceeding or petition shall not be dismissed, or such writ, judgment, warrant of attachment, execution or similar process shall not be released, vacated or fully bonded in each case within 60 days after commencement, filing or levy; (ii) either Co-Borrower or any Subsidiary of a Co-Borrower admits the material allegations of a petition against it in any Insolvency Proceeding, or an order for relief (or similar order under non-U.S. law) is ordered in any Insolvency Proceeding; or (iii) either Co-Borrower or any Subsidiary of a Co-Borrower acquiesces in the appointment of a receiver, trustee, custodian, conservator, liquidator, mortgagee in possession (or agent therefor), or other similar Person for itself or a substantial portion of its property or business; or

(g) ERISA. (i) An ERISA Event shall occur with respect to a Plan or Multiemployer Plan which has resulted or could reasonably be expected to result in liability of either Co-Borrower under Title IV of ERISA to the Plan, Multiemployer Plan or the PBGC in an aggregate amount in excess of $10,000,000.00; (ii) the present value of all benefit liabilities under each Plan (based on the assumptions used to fund such Plan), as of the last annual valuation date applicable thereto, exceeds by more than $25,000,000.00 the value of the assets of such Plan; or (iii) either Co-Borrower or any ERISA Affiliate shall fail to pay when due, any

installment payment with respect to its withdrawal liability under Section 4201 of ERISA under a Multiemployer Plan in an aggregate amount in excess of $100,000.00; or

(h) Monetary Judgments or Orders. One or more non-interlocutory judgments, non-interlocutory orders, decrees, arbitration awards or administrative orders is entered against either Co-Borrower or any Subsidiary of a Co-Borrower, which such judgment, order, decree or award is not effectively stayed pending appeal thereof, involving in the aggregate a liability as to any single or related series of transactions, incidents or conditions, to pay an amount of $100,000.00 or more unless such Co-Borrower has demonstrated to the satisfaction of the Administrative Agent that such Co-Borrower has established adequate reserves for such liability; or

(i) Non-Monetary Judgments or Orders. Any non-monetary judgment, order or decree is entered against either Co-Borrower or any Subsidiary of a Co-Borrower which does or would reasonably be expected to have a Material Adverse Effect; or

(j) Change of Control. There occurs any Change of Control not previously approved by the Banks, including without limitation any Change of Control arising as a result of any pledge, hypothecation assignment or other transfer not previously approved by the Banks; or

(k) Adverse Change. There occurs a Material Adverse Effect; or

(l) Guarantor Defaults. Either Guarantor fails to perform or observe any term, covenant or agreement in the Guaranty executed by such Guarantor; including without limitation the failure of Avista Capital to maintain minimum Net Worth at least equal to $160,000,000.00, or Avista Capital fails to perform under any subordination agreement issued for the benefit of the Banks or such Guaranty or any subordination agreement issued for the benefit of the Banks is for any reason (other than satisfaction in full of all Obligations and the termination of the Loans) partially (including with respect to future advances) or wholly revoked or invalidated, or otherwise ceases to be in full force and effect, or such Guarantor or any other Person contests in any manner the validity or enforceability thereof or denies that it has any further liability or obligation thereunder, or any event described at subsections (e), (f), (g), (h), (i) or (k) of this Section occurs with respect to such Guarantor; or

(m) Guarantor Cross-Default. Either Guarantor or any of their subsidiaries (i) fail to make any payment in respect of (A) any Indebtedness or Contingent Obligation owing to either Agent or an Affiliate of either Agent or (B) in respect of any Indebtedness or Contingent Obligation having an aggregate principal amount of more than $1,000,000.00, when due (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise); or (ii) fail to perform or observe any other material condition or covenant, or any other event shall occur or condition exist, under any agreement or instrument relating to any such Indebtedness or Contingent Obligation, if, after expiration of any grace or cure period therein provided, the effect of such failure, event or condition is to cause, or to permit the holder or holders of such Indebtedness or beneficiary or beneficiaries of such Indebtedness (or a trustee or agent on behalf of such holder or holders or beneficiary or beneficiaries) to cause such

Indebtedness to be declared to be due and payable prior to its stated maturity, or such Contingent Obligation to become payable or cash collateral in respect thereof to be demanded; or

(n) Downgrade of Avista Corporation The long-term indebtedness of Avista Corporation is rated below BB+ or the equivalent thereof by Standard & Poor's Ratings Group, a division of McGraw-Hill, Inc., or Ba1 or the equivalent thereof by Moody's Investors Services, Inc.

9.02 Remedies. If any Event of Default occurs, the Administrative Agent may and shall, at the request of the Required Banks:

(a) declare an amount equal to the maximum aggregate amount that is or at any time thereafter may become available for drawing by the beneficiary under any outstanding Letters of Credit (whether or not any beneficiary shall have presented, or shall be entitled at such time to present, the drafts or other documents required to draw under such Letters of Credit) to be immediately due and payable, and declare the unpaid principal amount of all outstanding Loans, all interest accrued and unpaid thereon, and all other amounts owing or payable hereunder or under any other Loan Document to be immediately due and payable, without presentment, demand, protest or other notice of any kind, all of which are hereby expressly waived by the Co-Borrowers; and

(b) exercise on behalf of itself and the Banks all rights and remedies available to it and the Banks under the Loan Documents or applicable law including, without limitation, seeking to lift the stay in effect under the Insolvency Proceeding;

provided, however, that upon the occurrence of any event specified in subsection (e) or (f) of Section 9.01, an amount equal to the maximum aggregate amount that is or at any time thereafter may become available for drawing by the beneficiary under any outstanding Letters of Credit (whether or not any beneficiary shall have presented, or shall be entitled at such time to present, the drafts or other documents required to draw under such Letters of Credit) together with the unpaid principal amount of all outstanding Loans and all interest and other amounts as aforesaid shall automatically become due and payable without further act of the Administrative Agent, the Issuing Bank or any Bank.

9.03 Rights Not Exclusive. The rights provided for in this Agreement and the other Loan Documents are cumulative and are not exclusive of any other rights, powers, privileges or remedies provided by law or in equity, or under any other instrument, document or agreement now existing or hereafter arising.

ARTICLE X

THE ADMINISTRATIVE AGENT

10.01 Appointment and Authorization.

(a) Each Bank hereby irrevocably (subject to Section 10.09) appoints, designates and authorizes the Administrative Agent to take such action on its behalf under the provisions of this Agreement and each other Loan Document and to exercise such powers and perform such duties as are expressly delegated to it by the terms of this Agreement or any other Loan Document, together with such powers as are reasonably incidental thereto. Notwithstanding any provision to the contrary contained elsewhere in this Agreement or in any other Loan Document, the Administrative Agent shall not have any duties or responsibilities, except those expressly set forth herein, nor shall the Administrative Agent have or be deemed to have any fiduciary relationship with any Bank, and no implied covenants, functions, responsibilities, duties, obligations or liabilities shall be read into this Agreement or any other Loan Document or otherwise exist against the Administrative Agent. Without limiting the generality of the foregoing sentence, the use of the term "agent" in this Agreement with reference to the Administrative Agent is not intended to connote any fiduciary or other implied (or express) obligations arising under agency doctrine of any applicable law. Instead, such term is used merely as a matter of market custom and is intended to create or reflect only an administrative relationship between independent contracting parties.

(b) The Issuing Bank shall act on behalf of the Banks with respect to any Letters of Credit Issued by it and the documents associated therewith until such time and except for so long as the Administrative Agent may agree at the request of the Required Banks to act for such Issuing Bank with respect thereto; provided, however, that the Issuing Bank shall have all of the benefits and immunities (i) provided to the Administrative Agent in this Article X with respect to any acts taken or omissions suffered by the Issuing Bank in connection with Letters of Credit Issued by it or proposed to be Issued by it and the application and agreements for letters of credit pertaining to the Letters of Credit as fully as if the term "Agent", as used in this Article X, included the Issuing Bank with respect to such acts or omissions, and (ii) as additionally provided in this Agreement with respect to the Issuing Bank.

10.02 Delegation of Duties. The Administrative Agent may execute any of its duties under this Agreement or any other Loan Document by or through agents, employees or attorneys-in-fact and shall be entitled to advice of counsel concerning all matters pertaining to such duties. The Administrative Agent shall not be responsible for the negligence or misconduct of any agent or attorney-in-fact that it selects with reasonable care.

10.03 Liability of Agent. None of the Agent-Related Persons shall (a) be liable for any action taken or omitted to be taken by any of them under or in connection with this Agreement or any other Loan Document or the transactions contemplated hereby (except for its own gross negligence or willful misconduct), or (b) be responsible in any manner to any of the Banks for any recital, statement, representation or warranty made by the Co-Borrowers or any Subsidiary or Affiliate of the Co-Borrowers, or any officer thereof, contained in this Agreement or in any

other Loan Document, or in any certificate, report, statement or other document referred to or provided for in, or received by the Agent-Related Persons under or in connection with, this Agreement or any other Loan Document, or for the value of or title to any Collateral, or the validity, effectiveness, genuineness, enforceability or sufficiency of this Agreement or any other Loan Document, or for any failure of the Co-Borrowers or any other party to any Loan Document to perform its obligations hereunder or thereunder. No Agent-Related Person shall be under any obligation to any Bank to ascertain or to inquire as to the observance or performance of any of the agreements contained in, or conditions of, this Agreement or any other Loan Document, or to inspect the properties, books or records of the Co-Borrowers or any of the Co-Borrowers’ Subsidiaries or Affiliates.

10.04 Reliance by Administrative Agent.

(a) The Administrative Agent shall be entitled to rely, and shall be fully protected in relying, upon any writing, resolution, notice, consent, certificate, affidavit, letter, telegram, facsimile, telex or telephone message, statement or other document or conversation believed by it to be genuine and correct and to have been signed, sent or made by the proper Person or Persons, and upon advice and statements of legal counsel (including counsel to the Co-Borrowers), independent accountants and other experts selected by the Administrative Agent. The Administrative Agent shall be fully justified in failing or refusing to take any action under this Agreement or any other Loan Document unless it shall first receive such advice or concurrence of the Banks as it deems appropriate and, if it so requests, it shall first be indemnified to its satisfaction by the Banks against any and all liability and expense which may be incurred by it by reason of taking or continuing to take any such action. The Administrative Agent shall in all cases be fully protected in acting, or in refraining from acting, under this Agreement or any other Loan Document in accordance with a request or consent of the Banks and such request and any action taken or failure to act pursuant thereto shall be binding upon all of the Banks.

(b) For purposes of determining compliance with the conditions specified in Section 5.01, each Bank that has executed this Agreement shall be deemed to have consented to, approved or accepted or to be satisfied with, each document or other matter either sent by the Administrative Agent to such Bank for consent, approval, acceptance or satisfaction, or required thereunder to be consented to or approved by or acceptable or satisfactory to the Bank.

10.05 Notice of Default. The Administrative Agent shall not be deemed to have knowledge or notice of the occurrence of any Default or Event of Default, except with respect to defaults in the payment of principal, interest and fees required to be paid to the Administrative Agent for the account of the Banks, unless the Administrative Agent shall have received written notice from a Bank or the Co-Borrowers referring to this Agreement, describing such Default or Event of Default and stating that such notice is a “notice of default”. The Administrative Agent will notify the Banks of its receipt of any such notice. The Administrative Agent shall take such action with respect to such Default or Event of Default as may be requested by the Required Banks in accordance with Article IX; provided, however, that unless and until the Administrative Agent has received any such request, the Administrative Agent may (but shall not be obligated

to) take such action, or refrain from taking such action, with respect to such Default or Event of Default as it shall deem advisable or in the best interest of the Banks.

10.06 Credit Decision. Each Bank acknowledges that none of the Agent-Related Persons has made any representation or warranty to it, and that no act by the Agents hereinafter taken, including any review of the affairs of the Co-Borrowers and their Subsidiaries, shall be deemed to constitute any representation or warranty by any Agent-Related Person to any Bank. Each Bank represents to the Administrative Agent that it has, independently and without reliance upon any Agent-Related Person and based on such documents and information as it has deemed appropriate, made its own appraisal of and investigation into the business, prospects, operations, property, financial and other condition and creditworthiness of the Co-Borrowers and their Subsidiaries, the value of and title to any Collateral, and all applicable bank regulatory laws relating to the transactions contemplated hereby, and made its own decision to enter into this Agreement and to extend credit to the Co-Borrowers hereunder. Each Bank also represents that it will, independently and without reliance upon any Agent-Related Person and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit analysis, appraisals and decisions in taking or not taking action under this Agreement and the other Loan Documents, and to make such investigations as it deems necessary to inform itself as to the business, prospects, operations, property, financial and other condition and creditworthiness of the Co-Borrowers. Except for notices, reports and other documents expressly herein required to be furnished to the Banks by the Administrative Agent, the Administrative Agent shall not have any duty or responsibility to provide any Bank with any credit or other information concerning the business, prospects, operations, property, financial and other condition or creditworthiness of the Co-Borrowers which may come into the possession of any of the Agent-Related Persons.

10.07 Indemnification. Whether or not the transactions contemplated hereby are consummated, the Banks shall indemnify upon demand the Agent-Related Persons (to the extent not reimbursed by or on behalf of the Co-Borrowers and without limiting the obligation of the Co-Borrowers to do so), pro rata in accordance with each Bank's Adjusted Pro Rata Share, from and against any and all Indemnified Liabilities; provided, however, that no Bank shall be liable for the payment to the Agent-Related Persons of any portion of such Indemnified Liabilities resulting from such Person's gross negligence or willful misconduct. Without limitation of the foregoing, each Bank shall reimburse the Administrative Agent, the Collateral Agent and the Documentation Agent upon demand for its ratable share of any costs or out-of-pocket expenses (including Attorney Costs) incurred by the Administrative Agent, the Collateral Agent or the Documentation Agent in connection with the preparation, execution, delivery, administration, modification, amendment or enforcement (whether through negotiations, legal proceedings or otherwise) of, or legal advice in respect of rights or responsibilities under, this Agreement, any other Loan Document, or any document contemplated by or referred to herein, to the extent that the Administrative Agent, the Collateral Agent or the Documentation Agent is not reimbursed for such expenses by or on behalf of the Co-Borrowers. The undertaking in this Section shall survive the payment of all Obligations hereunder and the resignation or replacement of the Administrative Agent or the Documentation Agent.

10.08 Agents in Individual Capacity. The Agents may make loans to, issue letters of credit for the account of, accept deposits from, acquire equity interests in and generally engage in any kind of banking, trust, financial advisory, underwriting or other business with the Co-Borrowers and their Subsidiaries and Affiliates as though they were not the Administrative Agent, the Collateral Agent or the Documentation Agent or an Issuing Bank hereunder and without notice to or consent of the Banks. The Banks acknowledge that, pursuant to such activities, the Administrative Agent, the Collateral Agent and the Documentation Agent may receive information regarding the Co-Borrowers or their Affiliates (including information that may be subject to confidentiality obligations in favor of the Co-Borrowers or such Subsidiary) and acknowledge that the Administrative Agent, the Collateral Agent and Documentation Agent shall be under no obligation to provide such information to them. With respect to its Loans, the Administrative Agent, the Collateral Agent and the Documentation Agent shall have the same rights and powers under this Agreement as any other Bank and may exercise the same as though it were not the Administrative Agent, the Collateral Agent or the Documentation Agent or an Issuing Bank, and the terms "Bank" and "Banks" include the Agents in their individual capacity.

10.09 Successor Administrative Agent. The Administrative Agent may resign as Administrative Agent upon thirty (30) days' notice to the Banks. If the Administrative Agent resigns under this Agreement, the Banks shall appoint, from among the Banks, a successor agent for the Banks. If no successor agent is appointed prior to the effective date of the resignation of the Administrative Agent, the Administrative Agent may appoint, after consulting with the Banks, a successor agent from among the Banks. Upon the acceptance of its appointment as successor agent hereunder, such successor agent shall succeed to all the rights, powers and duties of the retiring Administrative Agent and the term "Agent" shall mean such successor agent and the retiring Administrative Agent's appointment, powers and duties as Administrative Agent shall be terminated. After any retiring Administrative Agent's resignation hereunder as Administrative Agent, the provisions of this Article X and Sections 11.04 and 11.05 shall inure to its benefit as to any actions taken or omitted to be taken by it while it was Administrative Agent under this Agreement. If no successor agent has accepted appointment as Administrative Agent by the date which is thirty (30) days following a retiring Administrative Agent's notice of resignation, the retiring Administrative Agent's resignation shall nevertheless thereupon become effective and the Banks shall perform all of the duties of the Administrative Agent hereunder until such time, if any, as the Banks appoint a successor agent as provided for above.

10.10 Collateral Matters. (a) The Collateral Agent is authorized on behalf of all the Banks, without the necessity of any notice to or further consent from the Banks, from time to time to take any action with respect to any Collateral or the Loan Documents which may be necessary to perfect and maintain perfected the security interest in and Liens upon the Collateral granted pursuant to the Loan Documents.

(b) The Banks irrevocably authorize the Collateral Agent, at its option and in its discretion, to release any Lien granted to or held by the Collateral Agent upon any Collateral (i) upon payment in full of all Loans and all other Obligations known to the Collateral Agent and payable under this Agreement or any other Loan Document; (ii) constituting property sold or to be sold or disposed of as part of or in connection with any disposition permitted hereunder; (iii) constituting property in which the Co-Borrowers or any Subsidiary owned no interest at the time

the Lien was granted or at any time thereafter; (iv) constituting property leased to a Co-Borrower or any Subsidiary under a lease which has expired or been terminated in a transaction permitted under this Agreement or is about to expire and which has not been, and is not intended by the Co-Borrower or such Subsidiary to be, renewed or extended; (v) consisting of an instrument evidencing Indebtedness or other debt instrument, if the indebtedness evidenced thereby has been paid in full; or (vi) if approved, authorized or ratified in writing by the Banks. Upon request by the Collateral Agent at any time, the Banks will confirm in writing the Collateral Agent’s authority to release particular types or items of Collateral pursuant to this subsection 10.10(b), provided that the absence of any such confirmation for whatever reason shall not affect the Collateral Agent’s rights under this Section 10.10.

(c) Each Bank agrees with and in favor of each other (which agreement shall not be for the benefit of the Co-Borrowers or any Subsidiary) that the Co-Borrowers’ obligations to such Bank under this Agreement and the other Loan Documents is not and shall not be secured by any real property collateral now or hereafter acquired by such Bank.

10.11 Monitoring Responsibility. Each Bank will make its own credit decisions hereunder. Neither the Administrative Agent, the Collateral Agent or the Documentation Agent shall have any duty to monitor the Collateral used to calculate the Borrowing Base Cap, the amounts outstanding under sub-lines or the reporting requirements or the contents of reports delivered by the Co-Borrowers. Each Bank assumes the responsibility of keeping itself informed at all times.

ARTICLE XI

MISCELLANEOUS

11.01 Amendments and Waivers. No amendment or waiver of any provision of this Agreement or any other Loan Document, and no consent to any departure by the Co-Borrowers or any other Loan Party therefrom, shall be effective unless in writing signed by the Required Banks and the Co-Borrowers or the applicable Loan Party, as the case may be, and acknowledged by the Administrative Agent, and each such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given; provided, however, that no such amendment, waiver or consent shall, unless in writing and signed by each of the Banks directly affected thereby and by the Co-Borrowers, and acknowledged by the Administrative Agent, do any of the following:

(a) extend the Advance Maturity Date, the Maturity Date or the Expiration Date ;

(b) increase the Line Portion of any Bank;

(c) amend the definition of Borrowing Base Cap;

(d) reduce or delay the payment of the principal of, or the rate of interest specified herein on any Loan or L/C Borrowing or (subject to clause (iv) of the proviso

below) any fees or other amounts payable hereunder or under any other Loan Document; provided, however, that only the consent of the Required Banks shall be necessary to amend the definition of “Default Rate” or to waive any obligation of the Co-Borrowers to pay interest at the Default Rate;

(e) change the definition of Required Banks;

(f) change the Pro Rata Share or Adjusted Pro Rata Share of any Bank;

(g) amend this Section 11.01, Subsection 2.08 (b), Section 2.13 or Section 2.14 or any provision herein expressly providing for consent or other action by all the Banks;

(h) release any Guarantor from the liability under such Guarantor’s Guaranty; or

(i) release any part of the Collateral except for the release of cash, including without limitation, releases of cash from the Bank Blocked Account and the Co-Borrowers’ operating accounts.

and, provided further, that (i) no amendment, waiver or consent shall, unless in writing and signed by the relevant Issuing Bank in addition to the Required Banks or all the Banks, as the case may be, affect the rights or duties of the Issuing Bank under this Agreement relating to any Letter of Credit issued or to be issued by it; (ii) no amendment, waiver or consent shall, unless in writing and signed by the Administrative Agent in addition to the Required Banks or all the Banks, as the case may be, affect the rights or duties of the Administrative Agent under this Agreement or any other Loan Document; and (iv) the Agent Fee may be amended, or rights or privileges thereunder waived, in a writing executed only by the parties thereto. Notwithstanding anything to the contrary herein, any Bank that has failed to fund any portion of any Loans, or participations in L/C Obligations required to be funded by it hereunder shall not have any right to approve or disapprove any amendment, waiver or consent hereunder; provided, however, except as a result of the implementation of Section 2.14, the Pro Rata Share or Adjusted Pro Rata Share of such Bank may not be increased without the consent of such Bank, no payment to such Bank shall be decreased or postponed without the consent of such Bank, and the Applicable Margin may not be decreased without the consent of such Bank.

11.02 Notices.

(a) General. Unless otherwise expressly provided herein, all notices and other communications provided for hereunder shall be in writing (including by facsimile transmission) and mailed, faxed or delivered, to the address, facsimile number or (subject to subsection (c) below) electronic mail address specified for notices on Schedule 11.02; or, in the case of the Co-Borrowers, the Administrative Agent, or the Issuing Bank, to such other address as shall be designated by such party in a notice to the other parties, and in the case of any other party, to such other address as shall be designated by such party in a notice to the Co-Borrowers, the Administrative Agent and the Issuing Bank. All such notices and other communications shall be

deemed to be given or made upon the earlier to occur of (i) actual receipt by the intended recipient and (ii) (A) if delivered by hand or by courier, when signed for by the intended recipient; (B) if delivered by mail, four Business Days after deposit in the mails, postage prepaid; and (C) if delivered by facsimile, when sent and receipt has been confirmed by telephone; provided, however, that notices and other communications to the Administrative Agent and the Issuing Bank pursuant to Article II shall not be effective until actually received by such Person. Any notice or other communication permitted to be given, made or confirmed by telephone hereunder shall be given, made or confirmed by means of a telephone call to the intended recipient at the number specified on Schedule 11.02, it being understood and agreed that a voicemail message shall in no event be effective as a notice, communication or confirmation hereunder.

(b) Effectiveness of Facsimile Documents and Signatures. Loan Documents may be transmitted and/or signed by facsimile. The effectiveness of any such documents and signatures shall, subject to applicable Law, have the same force and effect as manually-signed originals and shall be binding on all Loan Parties, the Administrative Agent and the Banks. The Administrative Agent may also require that any such documents and signatures be confirmed by a manually-signed original thereof; provided, however, that the failure to request or deliver the same shall not limit the effectiveness of any facsimile document or signature.

(c) Limited Use of Electronic Mail. Except in connection with or pursuant to the Wells Fargo Accounts, including the WellsNet Service, electronic mail and internet and intranet websites may be used only to distribute routine communications, such as financial statements and other information, and to distribute Loan Documents for execution by the parties thereto, and may not be used to deliver any notice hereunder.

(d) Reliance by Administrative Agent and Banks. The Administrative Agent and the Banks shall be entitled to rely and act upon any notices (including telephonic notices) purportedly given by or on behalf of the Co-Borrowers even if (i) such notices were not made in a manner specified herein, were incomplete or were not preceded or followed by any other form of notice specified herein, or (ii) the terms thereof, as understood by the recipient, varied from any confirmation thereof. The Co-Borrowers jointly and severally shall indemnify each Agent-Related Person and each Bank from all losses, costs, expenses and liabilities resulting from the reliance by such Person on each notice purportedly given by or on behalf of the Co-Borrowers. All telephonic notices to and other communications with the Administrative Agent may be recorded by the Administrative Agent, and each of the parties hereto hereby consents to such recording.

11.03 No Waiver; Cumulative Remedies. No failure by any Bank or the Agent to exercise, and no delay by any such Person in exercising, any right, remedy, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power or privilege. The rights, remedies, powers and privileges herein or therein provided are cumulative and not exclusive of any rights, remedies, powers and privileges provided by law.

11.04 Costs and Expenses. The Co-Borrowers agree (a) to pay or reimburse the Agents for all reasonable costs and expenses incurred in connection with the development, preparation, negotiation and execution of this Agreement and the other Loan Documents and any amendment, waiver, consent or other modification of the provisions hereof and thereof (whether or not the transactions contemplated hereby or thereby are consummated), and the consummation and administration of the transactions contemplated hereby and thereby, including all Attorney Costs, and (b) to pay or reimburse the Administrative Agent and each Bank for all costs and expenses incurred in connection with the enforcement, attempted enforcement, or preservation of any rights or remedies under this Agreement or the other Loan Documents (including all such costs and expenses incurred during any "workout" or restructuring in respect of the Obligations and during any legal proceeding, including any proceeding under any Debtor Relief Law), including all Attorney Costs. The foregoing costs and expenses shall include all search, filing, recording, title insurance and appraisal charges and fees and taxes related thereto, and other out-of-pocket expenses incurred by the Administrative Agent and the cost of independent public accountants and other outside experts retained by the Administrative Agent or any Bank. The agreements in this Section shall survive the termination of this Agreement and repayment of all the other Obligations.

11.05 Indemnity. Whether or not the transactions contemplated hereby are consummated, the Co-Borrowers jointly and severally agree to indemnify, save and hold harmless each Agent-Related Person, each Bank and their respective Affiliates, directors, officers, employees, counsel, agents and attorneys-in-fact (collectively the "Indemnitees") from and against: (a) any and all claims, demands, actions or causes of action that are asserted against any Indemnitee by any Person (other than the Administrative Agent or any Bank) relating directly or indirectly to a claim, demand, action or cause of action that such Person asserts or may assert against any Loan Party, any Affiliate of any Loan Party or any of their respective officers or directors; (b) any and all claims, demands, actions or causes of action that may at any time (including at any time following repayment of the Obligations and the resignation or removal of the Administrative Agent or the replacement of any Bank) be asserted or imposed against any Indemnitee, arising out of or relating to, the Loan Documents, any predecessor loan documents, the use or contemplated use of the proceeds of any Credit Extension, or the relationship of any Loan Party, the Administrative Agent and the Banks under this Agreement or any other Loan Document; (c) any administrative or investigative proceeding by any Governmental Authority arising out of or related to a claim, demand, action or cause of action described in subsection (a) or (b) above; and (d) any and all liabilities (including liabilities under indemnities), losses, costs or expenses (including Attorney Costs) that any Indemnitee suffers or incurs as a result of the assertion of any foregoing claim, demand, action, cause of action or proceeding, or as a result of the preparation of any defense in connection with any foregoing claim, demand, action, cause of action or proceeding, in all cases, **WHETHER OR NOT ARISING OUT OF THE NEGLIGENCE OF AN INDEMNITEE,** and whether or not an Indemnitee is a party to such claim, demand, action, cause of action or proceeding (all the foregoing, collectively, the "Indemnified Liabilities"); provided that no Indemnitee shall be entitled to indemnification for any claim caused by its own gross negligence or willful misconduct or for any loss asserted against it by another Indemnitee. The agreements in this Section shall survive the termination of this Agreement and repayment of all the other Obligations.

11.06 Payments Set Aside. To the extent that the Co-Borrowers make a payment to the Administrative Agent or the Banks, or the Administrative Agent or the Banks exercise their right of set-off, and such payment or the proceeds of such set-off or any part thereof are subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by the Administrative Agent or such Bank in its discretion) to be repaid to a trustee, receiver or any other party, in connection with any Insolvency Proceeding or otherwise, then (a) to the extent of such recovery the obligation or part thereof originally intended to be satisfied shall be revived and continued in full force and effect as if such payment had not been made or such set-off had not occurred, and (b) each Bank severally agrees to pay to the Administrative Agent upon demand its pro rata share of any amount so recovered from or repaid by the Administrative Agent.

11.07 Successors and Assigns. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns, except that the Co-Borrowers may not assign or transfer any of their rights or Obligations under this Agreement without the prior written consent of the Administrative Agent and each Bank.

11.08 Assignments, Participations, Etc.

(a) Any Bank, at any time may assign and delegate to one or more Eligible Assignees (each an "Assignee") all, or any ratable part of all, of the Loans, the Borrowing Base Line, the Collateralized L/C Line, the L/C Obligations and the other rights and obligations of such Bank hereunder, in a minimum amount of $1,000,000.00; provided, however, that the Co-Borrowers and the Administrative Agent may continue to deal solely and directly with such Bank in connection with the interest so assigned to an Assignee until (i) written notice of such assignment, together with payment instructions, addresses and related information with respect to the Assignee, shall have been given to the Co-Borrowers and the Administrative Agent by such Bank and the Assignee; (ii) such Bank and its Assignee shall have delivered to the Co-Borrowers and the Administrative Agent an Assignment and Acceptance ("Assignment and Acceptance") in form attached hereto as Exhibit D, together with any Note or Notes subject to such assignment; and (iii) the assignor Bank or Assignee has paid to the Administrative Agent a processing fee in the amount of $2,500.00.

(b) From and after the date that the Administrative Agent notifies the assignor Bank that it has received an executed Assignment and Acceptance and payment of the above-referenced processing fee, (i) the Assignee thereunder shall be a party hereto and, to the extent that rights and obligations hereunder have been assigned to it pursuant to such Assignment and Acceptance, shall have the rights and obligations of a Bank under the Loan Documents, and (ii) the assignor Bank shall, to the extent that rights and obligations hereunder and under the other Loan Documents have been assigned by it pursuant to such Assignment and Acceptance, relinquish its rights and be released from its obligations under the Loan Documents.

(c) The Co-Borrowers shall execute and deliver to the Administrative Agent, new Notes evidencing such Assignee's assigned Loans and Line Portion and, if the assignor Bank has retained a portion of its Loans and its Line Portion, replacement Notes in the principal

amount of the Loans retained by the assignor Bank (such Notes to be in exchange for, but not in payment of, the Notes held by such Bank). Immediately upon each Assignee's making its processing fee payment under the Assignment and Acceptance, this Agreement shall be deemed to be amended to the extent, but only to the extent, necessary to reflect the addition of the Assignee and the resulting adjustment of the Line Portion arising therefrom. The Line Portion allocated to each Assignee shall reduce such Line Portion of the assigning Bank pro tanto. Upon such Assignment, Administrative Agent is authorized to revise Schedule 2.01 and Schedule 11.02 to reflect the adjusted status of the Banks.

(d) Any Bank may at any time sell to one or more commercial banks or other Persons not Affiliates of the Co-Borrowers (a "Participant") participating interests in any Loans, the Line Portion of that Bank and the other interests of that Bank (the "originating Bank") hereunder and under the other Loan Documents; provided, however, that (i) the originating Bank's obligations under this Agreement shall remain unchanged, (ii) the originating Bank shall remain solely responsible for the performance of such obligations, (iii) the Co-Borrowers, the Issuing Bank and the Administrative Agent shall continue to deal solely and directly with the originating Bank in connection with the originating Bank's rights and obligations under this Agreement and the other Loan Documents, and (iv) no Bank shall transfer or grant any participating interest under which the Participant has rights to approve any amendment to, or any consent or waiver with respect to, this Agreement or any other Loan Document, except to the extent such amendment, consent or waiver would require unanimous consent of the Banks as described in the first proviso to Section 11.01. In the case of any such participation, the Participant shall not have any rights under this Agreement, or any of the other Loan Documents, and all amounts payable by the Co-Borrowers hereunder shall be determined as if such Bank had not sold such participation; except that, if amounts outstanding under this Agreement are due and unpaid, or shall have been declared or shall have become due and payable upon the occurrence of an Event of Default, each Participant shall be deemed to have the right of set-off in respect of its participating interest in amounts owing under this Agreement to the same extent as if the amount of its participating interest were owing directly to it as a Bank under this Agreement.

(e) Each Bank agrees to take normal and reasonable precautions and exercise due care to maintain the confidentiality of all information identified as "confidential" or "secret" by the Co-Borrowers and provided to it by the Co-Borrowers or any Subsidiary, or by the Administrative Agent on a Co-Borrower's or Subsidiary's behalf, under this Agreement or any other Loan Document, and neither it nor any of its Affiliates shall use any such information other than in connection with or in enforcement of this Agreement and the other Loan Documents; except to the extent such information (i) was or becomes generally available to the public other than as a result of disclosure by the Bank, or (ii) was or becomes available on a non-confidential basis from a source other than the Co-Borrowers, provided that such source is not bound by a confidentiality agreement with, or under obligation of confidentiality, the Co-Borrowers known to the Bank; provided, however, that any Bank may disclose such information (A) at the request or pursuant to any requirement of any Governmental Authority to which the Bank is subject or in connection with an examination of such Bank by any such authority; (B) pursuant to subpoena or other court process; (C) when required to do so in accordance with the provisions of any applicable Requirement of Law; (D) to the extent reasonably required in connection with any litigation or proceeding to which the Administrative Agent, any Bank or their respective

Affiliates may be party; (E) to the extent reasonably required in connection with the exercise of any remedy hereunder or under any other Loan Document; (F) to such Bank's independent auditors and other professional advisors; (G) to any Affiliate of such Bank, or to any Participant or Assignee, actual or potential, provided that such Affiliate, Participant or Assignee agrees to keep such information confidential to the same extent required of the Banks hereunder, and (H) as to any Bank, as expressly permitted under the terms of any other document or agreement regarding confidentiality to which a Co-Borrower is party or is deemed party with such Bank.

(f) Notwithstanding any other provision in this Agreement, any Bank may at any time create a security interest in, or pledge, all or any portion of its rights under and interest in this Agreement and the Note held by it in favor of any Federal Reserve Bank in accordance with Regulation A of the FRB or U.S. Treasury Regulation 31 C.F.R. § 203.14, and such Federal Reserve Bank may enforce such pledge or security interest in any manner permitted under applicable law.

(g) Notwithstanding anything to the contrary contained herein, if at any time the Administrative Agent assigns all of its Line Portion and Loans pursuant to subsection (b) above, the Administrative Agent shall, (i) upon 30 days' notice to the Co-Borrowers and the Banks, resign as Issuing Bank. In the event of any such resignation as Issuing Bank, the Co-Borrowers shall be entitled to appoint from among the Banks a successor Issuing Bank hereunder; provided, however, that no failure by the Co-Borrowers to appoint any such successor shall affect the resignation of the Administrative Agent as Issuing Bank. Administrative Agent shall retain all the rights and obligations of the Issuing Bank hereunder with respect to all Letters of Credit outstanding as of the effective date of its resignation as Issuing Bank and all L/C Obligations with respect thereto (including the right to require the Banks to make Loans or fund participations in L/C Obligations pursuant to Section 3.03).

11.09 Set-off. In addition to any rights and remedies of the Banks provided by law, if an Event of Default exists or the Loans have been accelerated, each Bank is authorized at any time and from time to time, without prior notice to the Co-Borrowers, any such notice being waived by the Co-Borrowers to the fullest extent permitted by law, to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held by, and other indebtedness at any time owing by, such Bank to or for the credit or the account of the Co-Borrowers against any and all Obligations owing to such Bank, now or hereafter existing, irrespective of whether or not the Administrative Agent or such Bank shall have made demand under this Agreement or any Loan Document and although such Obligations may be contingent or unmatured. Each Bank agrees promptly to notify the Co-Borrowers and the Administrative Agent after any such set-off and application made by such Bank; provided, however, that the failure to give such notice shall not affect the validity of such set-off and application.

11.10 Automatic Debits of Fees. With respect to any commitment fee, arrangement fee, letter of credit fee or other fee, or any other cost or expense (including Attorney Costs) due and payable to the Administrative Agent, the Issuing Bank or any Bank under the Loan Documents, the Co-Borrowers hereby irrevocably authorize the Administrative Agent to debit any deposit accounts of the Co-Borrowers with Wells Fargo in an amount such that the aggregate amount debited from all such deposit accounts does not exceed such fee or other cost or expense. If

there are insufficient funds in such deposit accounts to cover the amount of the fee or other cost or expense then due, such debits will be reversed (in whole or in part, in the Administrative Agent's sole discretion) and such amount not debited shall be deemed to be unpaid. No such debit under this Section shall be deemed a set-off.

11.11 Notification of Addresses, Lending Offices, Etc. Each Bank shall notify the Administrative Agent in writing of any changes in the address to which notices to the Bank should be directed, of addresses of any Lending Office, of payment instructions in respect of all payments to be made to it hereunder and of such other administrative information as the Administrative Agent shall reasonably request.

11.12 Bank Blocked Accounts Charges and Procedures: Paribas Investment Accounts.

(a) During an Activation Period, Collateral Agent may approve a request to transfer, at Collateral Agent's sole discretion, of any collected and available balances in the Bank Blocked Accounts each day by wire transfer to the Operating Accounts, the Wells Fargo Investment Accounts, or the Paribas Investment Accounts. Funds are not available if, in the reasonable determination of Collateral Agent, they are subject to a hold, dispute or legal process preventing their withdrawal. The Co-Borrowers agree that during an Activation Period, they cannot, and will not, withdraw any monies from the Bank Blocked Accounts until such time as Collateral Agent no longer claims any interest in the Bank Blocked Accounts. The Co-Borrowers will not permit the Bank Blocked Accounts, the Operating Accounts, the Wells Fargo Investment Accounts or the Paribas Investment Accounts to become subject to any other pledge, assignment, lien, charge or encumbrance of any kind, nature or description. Co-Borrowers acknowledge that the Collateral Agent and the Banks have a security interest in all cash, bank accounts and other accounts of Co-Borrowers, and thus to better enable the Collateral Agent to have access to and a right of set off against all such cash, bank accounts and other accounts, Co-Borrowers agree and covenant to maintain no deposit accounts except (x) with Collateral Agent, (y) the Bank Blocked Accounts, the Operating Accounts and the Wells Fargo Investment Accounts, the Wells Fargo Collateral Account or with Wells Fargo as otherwise permitted by the Collateral Agent, on behalf of the Banks, and (z) with other institutions approved by the Collateral Agent, on behalf of the Banks, provided that the Collateral Agent shall retain a perfected security interest in such accounts.

(b) During an Activation Period and provided there exists an Event of Default hereunder, the Collateral Agent shall have the right, in accordance with the terms and conditions of this Agreement and the Override Agreement, to cause the transfer to the Collateral Agent of amounts contained in the Bank Blocked Accounts, the Operating Accounts, the Wells Fargo Investment Accounts, or the Paribas Investment Accounts, so long as such instruction to transfer is either in accordance with a request from the Co-Borrowers or pursuant to the Collateral Agent's rights hereunder.

11.13 Counterparts. This Agreement may be executed in any number of separate counterparts, each of which, when so executed, shall be deemed an original, and all of said counterparts taken together shall be deemed to constitute but one and the same instrument.

11.14 Severability. The illegality or unenforceability of any provision of this Agreement or any instrument or agreement required hereunder shall not in any way affect or impair the legality or enforceability of the remaining provisions of this Agreement or any instrument or agreement required hereunder.

11.15 No Third Parties Benefited. This Agreement is made and entered into for the sole protection and legal benefit of the Co-Borrowers, the Banks, the Administrative Agent and the Agent-Related Persons, and their permitted successors and assigns, and no other Person shall be a direct or indirect legal beneficiary of, or have any direct or indirect cause of action or claim in connection with, this Agreement or any of the other Loan Documents.

11.16 Governing Law and Jurisdiction.

(a) THIS AGREEMENT AND THE NOTES SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAW (WITHOUT REFERENCE TO PRINCIPLES OF CONFLICTS OF LAWS) OF THE STATE OF NEW YORK, PROVIDED THAT THE ADMINISTRATIVE AGENT AND THE BANKS SHALL RETAIN ALL RIGHTS ARISING UNDER FEDERAL LAW.

(b) ANY LEGAL ACTION OR PROCEEDING WITH RESPECT TO THIS AGREEMENT OR ANY OTHER LOAN DOCUMENT MAY BE BROUGHT IN THE COURTS OF THE STATE OF NEW YORK OR OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK, AND BY EXECUTION AND DELIVERY OF THIS AGREEMENT, EACH OF THE CO-BORROWERS, THE ADMINISTRATIVE AGENT AND THE BANKS CONSENTS, FOR ITSELF AND IN RESPECT OF ITS PROPERTY, TO THE NON-EXCLUSIVE JURISDICTION OF THOSE COURTS. EACH OF THE CO-BORROWERS, THE ADMINISTRATIVE AGENT AND THE BANKS IRREVOCABLY WAIVES ANY OBJECTION, INCLUDING ANY OBJECTION TO THE LAYING OF VENUE OR BASED ON THE GROUNDS OF FORUM NON CONVENIENS, WHICH IT MAY NOW OR HEREAFTER HAVE TO THE BRINGING OF ANY ACTION OR PROCEEDING IN SUCH JURISDICTION IN RESPECT OF THIS AGREEMENT OR ANY DOCUMENT RELATED HERETO. THE CO-BORROWERS HEREBY WAIVE PERSONAL SERVICE OF ANY AND ALL PROCESS UPON THE CO-BORROWERS AND APPOINT CT CORPORATION SYSTEM AT 111 EIGHTH AVENUE, NEW YORK, NY 10011, AS REGISTERED AGENT FOR THE PURPOSE OF RECEIVING AND FORWARDING SERVICE OF PROCESS WITHIN THE STATE OF NEW YORK AND AGREE TO OBTAIN A LETTER FROM CT CORPORATION, ACKNOWLEDGING SAME. CO-BORROWERS AGREE TO MAINTAIN A REGISTERED AGENT FOR SERVICE OF PROCESS DURING THE TERM OF THIS AGREEMENT AND TO PROVIDE THE ADMINISTRATIVE AGENT WITH THIRTY (30) DAYS ADVANCE NOTICE PRIOR TO ANY RESIGNATION OF ANY SUCH REGISTERED AGENT.

11.17 Waiver of Jury Trial. EACH OF THE CO-BORROWERS, THE BANKS AND THE ADMINISTRATIVE AGENT WAIVE THEIR RESPECTIVE RIGHTS TO A TRIAL BY JURY OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR

ARISING OUT OF OR RELATED TO THIS AGREEMENT, THE OTHER LOAN DOCUMENTS, OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY, IN ANY ACTION, PROCEEDING OR OTHER LITIGATION OF ANY TYPE BROUGHT BY ANY OF THE PARTIES AGAINST ANY OTHER PARTY OR ANY AGENT-RELATED PERSON, PARTICIPANT OR ASSIGNEE, WHETHER WITH RESPECT TO CONTRACT CLAIMS, TORT CLAIMS, OR OTHERWISE. EACH OF THE CO-BORROWERS, THE BANKS AND THE ADMINISTRATIVE AGENT AGREE THAT ANY SUCH CLAIM OR CAUSE OF ACTION SHALL BE TRIED BY A COURT TRIAL WITHOUT A JURY. WITHOUT LIMITING THE FOREGOING, THE PARTIES FURTHER AGREE THAT THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY IS WAIVED BY OPERATION OF THIS SECTION AS TO ANY ACTION, COUNTERCLAIM OR OTHER PROCEEDING WHICH SEEKS, IN WHOLE OR IN PART, TO CHALLENGE THE VALIDITY OR ENFORCEABILITY OF THIS AGREEMENT OR THE OTHER LOAN DOCUMENTS OR ANY PROVISION HEREOF OR THEREOF. THIS WAIVER SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS.

11.18 Entire Agreement. THIS AGREEMENT, TOGETHER WITH THE OTHER LOAN DOCUMENTS, EMBODIES THE ENTIRE AGREEMENT AND UNDERSTANDING AMONG THE CO-BORROWERS, THE BANKS AND THE ADMINISTRATIVE AGENT, AND SUPERSEDES ALL PRIOR OR CONTEMPORANEOUS AGREEMENTS AND UNDERSTANDINGS OF SUCH PERSONS, VERBAL OR WRITTEN, RELATING TO THE SUBJECT MATTER HEREOF AND THEREOF.

11.19 Fortis Capital Corp. as Documentation Agent. Fortis Capital Corp., in its capacity as Documentation Agent, shall have no duties, rights or obligations under the Credit Agreement or any other Loan Document, including, but not limited to, Article X of the Credit Agreement other than the preparation of this Agreement and the other Loan Documents relating thereto. Fortis Capital Corp.'s duties, rights, and obligations under the Loan Documents shall be only those of a Bank.

11.20 Reliance by Co-Borrowers. Co-Borrowers shall be entitled to rely on any consent, approval or decision of BNP Paribas in writing, as Administrative Agent.

11.21 Nature of Obligations. The obligations of the Co-Borrowers hereunder and under each other Loan Document are joint and several in nature.

11.22 Amendment and Restatement. This Agreement is in amendment and restatement of the Existing Credit Agreement in its entirety. The Co-Borrowers hereby agree that (i) the Loans outstanding under the Existing Credit Agreement shall be deemed to be outstanding under this Agreement; (ii) all Letters of Credit issued and outstanding under the Existing Credit Agreement shall be deemed to be outstanding under this Agreement; (iii) all accrued and unpaid interest and fees under the Existing Credit Agreement shall be deemed to be outstanding under this Agreement; and (iv) this Agreement is not intended to be an extinguishment or novation of

the Co-Borrowers' Obligations under the Existing Credit Agreement, but rather in renewal and extension of such Obligations.

[Remainder of page intentionally left blank]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered by their proper and duly authorized officers as of the day and year first above written.

AVISTA ENERGY, INC.,
a Washington corporation

By: /s/ Dennis Vermillion
Name: Dennis Vermillion
Title: President & C.O.O.

AVISTA ENERGY CANADA LTD.,
a corporation of the province of Alberta, Canada

By: /s/ Dennis Vermillion
Name: Dennis Vermillion
Title: President & C.O.O.

Co-Borrowers' Address:
201 W. North River Drive
Suite 610
Spokane, Washington 99201
Attention: Dennis Vermillion
Telephone: (509) 688-6000
Facsimile: (509) 688-6154
E-mail: dennis.vermillion@avistaenergy.com

BNP PARIBAS,
as Administrative Agent, Collateral Agent,
and an Issuing Bank,

By: /s/ A-C. Mathiot
Name: A-C. Mathiot
Title: Director

By: /s/ Keith Cox
Name: Keith Cox
Title: Director

787 Seventh Avenue
New York, NY 10019
Attention: Anne-Catherine Mathiot
Phone: 212-841-2575
Fax: 212-841-2536
E-mail: anne-catherine.mathiot@americas.bnpparibas.com

BNP PARIBAS,
as a Bank

By: /s/ A-C. Mathiot
Name: A-C. Mathiot
Title: Director

By: /s/ Keith Cox
Name: Keith Cox
Title: Director

787 Seventh Avenue
New York, NY 10019
Attention: Anne-Catherine Mathiot
Phone: 212-841-2575
Fax: 212-841-2536
E-mail: anne-catherine.mathiot@americas.bnpparibas.com

FORTIS CAPITAL CORP.,
Documentation Agent and an Issuing Bank

By: /s/ Irene C. Rummel
Name: Irene C. Rummel
Title: Senior Vice President

By: /s/ Chad Clark
Name: Chad Clark
Title: Vice President

15455 North Central Parkway
Suite 1400
Addison, TX 75001
Attention: Irene Rummel
Phone: 214-953-9313
Fax: 214-969-9332
E-mail: irene.rummel@fortiscapitalusa.com

FORTIS CAPITAL CORP.,
as a Bank

By: /s/ Irene C. Rummel
Name: Irene C. Rummel
Title: Senior Vice President

By: /s/ Chad Clark
Name: Chad Clark
Title: Vice President

15455 North Central Parkway
Suite 1400
Addison, TX 75001
Attention: Irene Rummel
Phone: 214-953-9313
Fax: 214-969-9332
E-mail: irene.rummel@fortiscapitalusa.com

NATEXIS BANQUES POPULAIRES
as a Bank

By: /s/ David Pershad
Name: David Pershad
Title: Vice President

By: /s/ Guillaume de Parscau
Name: Guillaume de Parscau
Title: First Vice President & Manager Commodities Finance Group

1251 Avenue of the Americas
34th Floor
New York, NY 10020
Attention: David Pershad
Phone: 212-872-5015
Fax: 212-354-9095
E-mail: david.pershad@nyc.nxbp.com

Exhibit 10.3

FIRST AMENDMENT TO
THIRD AMENDED AND RESTATED CREDIT AGREEMENT

THIS FIRST AMENDMENT TO THIRD AMENDED AND RESTATED CREDIT AGREEMENT (this "Amendment") made as of the 23rd day of July, 2004, among AVISTA ENERGY, INC., a Washington corporation, and AVISTA ENERGY CANADA LTD., a corporation of the province of Alberta, Canada (each a "Borrower" and collectively, the "Borrowers"), BNP PARIBAS ("BNP Paribas"), individually and as administrative agent, collateral agent and an issuing bank, FORTIS CAPITAL CORP. ("Fortis"), individually and as documentation agent and an issuing bank, and NATEXIS BANQUES POPULAIRES ("Natexis", and together with BNP Paribas and Fortis, the "Banks").

WHEREAS, the Borrowers and the Banks entered into a Third Amended and Restated Credit Agreement effective as of July 25, 2003 (the "Credit Agreement");

WHEREAS, the Borrowers have requested that the Banks extend the Expiration Date contained in the Credit Agreement, and the Banks are willing to do so subject to the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties hereto, intending to be legally bound, agree as follows:

1. Defined Terms. All capitalized terms used but not otherwise defined in this Amendment shall have the meaning ascribed to them in the Credit Agreement. Unless otherwise specified, all section references herein refer to sections of the Credit Agreement.

2. Amendments to Credit Agreement. The Credit Agreement is hereby amended as follows:

2.1 Section 1.01 – Definition of "Expiration Date". Clause (a) of the definition of "Expiration Date" is amended to read as follows:

"(a) July 22, 2005; or"

2.2 Section 1.01 – Definition of "Maturity Date". The definition of "Maturity Date" is amended and restated in its entirety to read as follows:

"'Maturity Date' means July 23, 2007."

2.3 Schedules. Schedules 6.05, 8.01 and 8.06 to the Credit Agreement are deleted and replaced with Schedules 6.05, 8.01, and 8.06 attached hereto.

3. Effectiveness of Amendment. This Amendment shall be effective upon receipt by the Banks of:

(a) An executed copy of this Amendment;

(b) A Confirmation of Guaranty, in the form attached hereto, signed by each of the Guarantors;

(c) Payment of all fees owing to the Banks, pursuant to the fee letters from Borrowers to each of the Banks executed in connection herewith;

(d) Resolutions from each of the Borrowers and each of the Guarantors, in form and substance satisfactory to the Banks, authorizing the execution and delivery of and performance under this Amendment and any documents or agreements entered into in connection therewith; and

(e) Such other documents and instruments as any Bank may reasonably request to reflect the changes set forth in this Amendment.

4. Ratifications, Representations and Warranties.

(a) The terms and provisions set forth in this Amendment shall modify and supersede all inconsistent terms and provisions set forth in the Credit Agreement and, except as expressly modified and superseded by this Amendment, the terms and provisions of the Credit Agreement are ratified and confirmed and shall continue in full force and effect. The Borrowers and the Banks agree that the Credit Agreement and the Loan Documents, as amended hereby, shall continue to be legal, valid, binding and enforceable in accordance with their respective terms.

(b) To induce the Banks to enter into this Amendment, each Borrower ratifies and confirms each representation and warranty set forth in the Credit Agreement as if such representations and warranties were made on the even date herewith, and further represents and warrants (i) that there has occurred since the date of the last financial statements delivered to the Banks no event or circumstance that has resulted or could reasonably be expected to result in a Material Adverse Effect, (ii) that no Event of Default exists on the date hereof, and (iii) that each Borrower is fully authorized to enter into this Amendment.

5. Benefits. This Amendment shall be binding upon and inure to the benefit of each Bank and each Borrower, and their respective successors and assigns; provided, however, that neither Borrower may, without the prior written consent of the Banks, assign any rights, powers, duties or obligations under this Amendment, the Credit Agreement, the Security Agreements or any of the other Loan Documents.

6. Construction. This Amendment shall be governed by and construed in accordance with the laws (without reference to principles of conflicts of laws) of the State of New York, provided that the Banks shall retain all rights arising under federal law.

7. Invalid Provisions. If any provision of this Amendment is held to be illegal, invalid or unenforceable under present or future laws, such provision shall be fully severable and the remaining provisions of this Amendment shall remain in full force and effect and shall not be affected by the illegal, invalid or unenforceable provision or by its severance.

8. Entire Agreement. The Credit Agreement, as amended by this Amendment, along with the other Loan Documents, contain the entire agreement among the parties regarding the subject matter hereof and supersede all prior written and oral agreements and understandings among the parties hereto regarding same.

9. Reference to Credit Agreement. The Credit Agreement and any and all other agreements, documents or instruments now or hereafter executed and delivered pursuant to the terms hereof or pursuant to the terms of the Credit Agreement, as amended hereby, are hereby amended so that any reference in the

Credit Agreement or the other Loan Documents to the Credit Agreement shall mean a reference to the Credit Agreement, as amended hereby.

10. Counterparts. This Amendment may be separately executed in any number of counterparts, each of which shall be an original, but all of which, taken together, shall be deemed to constitute one and the same agreement.

[remainder of page intentionally left blank; signature page follows]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed and delivered by their proper and duly authorized officers as of the day and year first above written.

AVISTA ENERGY, INC.,
a Washington corporation

By: /s/ Dennis P. Vermillion
Name: Dennis P. Vermillion
Title: President & C.O.O.

AVISTA ENERGY CANADA LTD.,
a corporation of the province of
Alberta, Canada

By: /s/ Dennis P. Vermillion
Name: Dennis P. Vermillion
Title: President & C.O.O.

Borrowers' Address:
201 W. North River Drive
Suite 610
Spokane, Washington 99201
Attention: Dennis Vermillion
Telephone: (509) 688-6000
Facsimile: (509) 688-6154
E-mail: dennis.vermillion@avistaenergy.com

BNP PARIBAS,
as Administrative Agent, Collateral Agent,
an Issuing Bank, and a Bank

By: /s/ Jordan Nenoff
Name: Jordan Nenoff
Title: Vice President

By: /s/ A-C. Mathiot
Name: A-C Mathiot
Title: Managing Director

787 Seventh Avenue
New York, NY 10019
Attention: Anne-Catherine Mathiot
Phone: 212-841-2575
Fax: 212-841-2536
E-mail: anne-catherine.mathiot@americas.bnpparibas.com

FORTIS CAPITAL CORP.,
as Documentation Agent, an Issuing Bank,
and a Bank

By: /s/ Irene C. Rummel
Name: Irene C. Rummel
Title: Senior Vice President

By: /s/ Cristina E. Roberts
Name: Cristina E. Roberts
Title: Managing Director Fortis Capital Corp.

15455 North Central Parkway
Suite 1400
Addison, TX 7501
Attention: Irene Rummel
Phone: 214-953-9313
Fax: 214-969-9332
E-mail: irene.rummel@fortiscapitalusa.com

NATEXIS BANQUES POPULAIRES
as a Bank

By: /s/ David Pershad
Name: David Pershad
Title: Vice President

By: /s/ Guillaume de Parscau
Name: Guillaume de Parscau
Title: First Vice President & Manager Commodities Finance Group

1251 Avenue of the Americas
34th Floor
New York, NY 10020
Attention: David Pershad
Phone: 212-872-5015
Fax: 212-354-9095
E-mail: david.pershad@nyc.nxbp.com

SECOND AMENDMENT TO THIRD AMENDED AND RESTATED CREDIT AGREEMENT

THIS SECOND AMENDMENT TO THIRD AMENDED AND RESTATED CREDIT AGREEMENT (this "Amendment") made as of the 13th day of July, 2005, among AVISTA ENERGY, INC., a Washington corporation, and AVISTA ENERGY CANADA LTD., a corporation of the province of Alberta, Canada (each a "Borrower" and collectively, the "Borrowers"), BNP PARIBAS ("BNP Paribas"), individually and as administrative agent, collateral agent and an issuing bank, FORTIS CAPITAL CORP. ("Fortis"), individually and as documentation agent and an issuing bank, and NATEXIS BANQUES POPULAIRES ("Natexis", and together with BNP Paribas and Fortis, the "Banks").

WHEREAS, the Borrowers and the Banks entered into a Third Amended and Restated Credit Agreement effective as of July 25, 2003, as amended by a First Amendment to Third Amended and Restated Credit Agreement dated as of July 23, 2004 (as amended, the "Credit Agreement");

WHEREAS, the Borrowers have requested that the Banks increase the total Line Portions to $145,000,000.00, extend the Expiration Date contained in the Credit Agreement, and make certain additional changes to the Credit Agreement, and the Banks are willing to do so subject to the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties hereto, intending to be legally bound, agree as follows:

1. **Defined Terms**. All capitalized terms used but not otherwise defined in this Amendment shall have the meaning ascribed to them in the Credit Agreement. Unless otherwise specified, all section references herein refer to sections of the Credit Agreement.

2. **Amendments to Credit Agreement**. The Credit Agreement is hereby amended as follows:

2.1 Section 1.01 - Definitions

(a) Definition of "Borrowing Base Cap."

(i) Substitute "$145,000,000.00" for $110,000,000.00" in paragraph (a).

(ii) Substitute "plus" for "less" in paragraph (c)(vii).

(iii) Add paragraph (c)(viii) as follows:

"(viii) the percentage of the Co-Borrowers' aggregate In-the-Money Positions by counterparty according to the following grid:

Advance Rate	**Remaining Time to Settlement Under Position (In terms of full calendar months after the calendar month in which the Borrowing Base Cap is being determined)**
70%	up to 6 months
50%	7 to 12 months
0%	over 12 months

in all cases, however, net of the following and subject to the following limitations:

(I) net of remaining forward out-of-the-money positions and accounts payable and other obligations of a Co-Borrower to the counterparty and net of purchases contracted for but not yet invoiced, as such amounts may be adjusted to account for the effective amount of posted cash and Letter of Credit support to each specific counterparty; and

(II) net of 50% of any Posted Collateral received in form of cash from counterparties; and

(III) with respect to each counterparty, under no event will the Co-Borrowers' aggregate In-the-Money Positions with such counterparty exceed 15% of the net in-the-money forward positions with all counterparties unless pre-approved by all the Banks in their sole discretion, or secured by letters of credit in form acceptable to all the Banks in their sole discretion and issued by banks approved by all the Banks in their sole discretion; and

(IV) under no event will the aggregate amount included pursuant to this paragraph (viii) exceed any amount determined by the following grid:

Line Utilization as of the Date of the Last Delivered Borrowing Base Report	Maximum Included Amount
(A) up to $100,000,000	$20,000,000, and
(B) $100,000,000 to $145,000,000	$25,000,000, less”

(iv) Change the following paragraph designations:

From	to
(c) (viii)	(c) (ix)
(c) (ix)	(c) (x)
(c) (x)	(c) (xi)
(c) (xi)	(c) (xii)

(v) Substitute “(c)(viii)” for “(c)(vii)” in the sentence beginning “In no event shall any amounts . . .”

(b) Definition of “Borrowing Base Line.” Substitute “$145,000,000.00” for “$110,000,000.00” each time the latter figure appears.

(c) Definition of “Dollar Advance.” The definition of “Dollar Advance” is amended to read as follows:

“‘Dollar Advance’ means any advance under the Borrowing Base Line other than an Overdraft Advance or a Daylight Overdraft. A Dollar Advance may be made in Dollars or Canadian dollars.”

(d) Definition of “Dollar Advance Sub-limit.” Amend the definition of “Dollar Advance Sub-limit” in its entirety to read as follows

"'Dollar Advance Sub-limit' means a limitation upon Dollar Advances under the Borrowing Base Line determined as follows:

Elected Line Cap	**Dollar Advance Sub-limit**	**Dollar Advance Sub-sub-limit for Dollar Advances in Canadian Dollars***
Up to $110,000,000.00	$ 30,000,000.00	$ 24,000,000.00
In excess of $110,000,000.00 up to $145,000,000.00	$ 50,000,000.00"	$ 40,000,000.00

* A sub-limit of the Dollar Advance Sub-limit

(e) Definition of "Effective Amount." The definition of "Effective Amount" is amended to read as follows:

"Effective Amount" means (a) with respect to any Revolving Loans on any date, the aggregate outstanding principal amount thereof after giving effect to any Borrowings and prepayments or repayments of Revolving Loans occurring on such date; and (b) with respect to any outstanding L/C Obligations on any date, the amount of such L/C Obligations on such date after giving effect to any Issuances of Letters of Credit occurring on such date and any other changes in the aggregate amount of the L/C Obligations as of such date, including changes as a result of expiration or cancellation, any reimbursements of outstanding unpaid drawings under any Letters of Credit or any reductions in the maximum amount available for drawing under Letters of Credit taking effect on such date. In determining the Effective Amount of any Dollar Advance or Letter of Credit that is denominated in Canadian dollars, Administrative Agent may at any time determine the Dollar Equivalent of such Dollar Advance or Letter of Credit and if Administrative Agent determines that the Dollar Equivalent is in excess of the U.S. Dollar amounts shown on Administrative Agent's books and records at such time, Administrative Agent may advise the Co-Borrowers. In such event, the Effective Amount of such Dollar Advance or Letter of Credit shall be deemed to be the Dollar Equivalent amount and Administrative Agent shall record and reflect such revised amount on its books and records. Such Dollar Equivalent

amount shall be used in applying all Caps and Sub-limits under this Agreement."

(f) Definition of "Elected Line Cap." Amend the definition of "Elected Line Cap" in its entirety to read as follows:

"'Elected Line Cap' means the amount which the Co-Borrowers may elect for purposes of determining availability under the Borrowing Base line from time to time or at any time, but no more frequently than six (6) times per calendar year, initially $110,000,000.00 which amount may be $60,000,000.00, $80,000,000.00, $100,000,000.00, $110,000,000.00, $135,000,000.00 or $145,000,000.00. The Elected Line Cap shall continue in effect until again changed by Co-Borrowers in accordance with this Agreement or until automatically reduced as hereinafter set forth. Notwithstanding the foregoing, the Co-Borrowers may not elect an Elected Line Cap unless Co-Borrowers' Net Working Capital and Net Worth at the time of election are greater than, or equal to, the amounts specified below:

(a) If the Co-Borrowers elect $60,000,000.00, their Net Working Capital must be at least $20,700,000.00 and their Net Worth must be at least $130,000,000.00; or

(b) If the Co-Borrowers elect $80,000,000.00, their Net Working Capital must be at least $23,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(c) If the Co-Borrowers elect $100,000,000.00, their Net Working Capital must be at least $27,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(d) If the Co-Borrowers elect $110,000,000.00, their Net Working Capital must be at least $29,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(e) If the Co-Borrowers elect $135,000,000.00, their Net Working Capital must be at

least $34,000,000.00 and their Net Worth must be at least $130,000,000.00; or

(f) If the Co-Borrowers elect $145,000,000.00, their Net Working Capital must be at least $36,000,000.00 and their Net Worth must be at least $130,000,000.00; or

The Co-Borrowers shall elect which Elected Line Cap is in effect from time to time by delivering to the Administrative Agent a written notice of such election in the form of Exhibit G which is attached hereto. In the event that after the Co-Borrowers make an Elected Line Cap election, the Co-Borrowers' Net Working Capital or Net Worth as reflected on a Compliance Certificate delivered to the Administrative Agent are not in compliance with the requirements set forth above, the Elected Line Cap shall be automatically reduced to the appropriate level set forth above to cause compliance with the requirements set forth above, provided that if the Co-Borrowers fail to qualify for (b) through (f) above, then the Elected Line Cap shall be $60,000,000.00. Such reduction shall take place upon Banks' approval of such Compliance Certificate or notice of election. Until such time as the Co-Borrowers elect a different Elected Line Cap, the Elected Line Cap shall remain unchanged unless the Co-Borrowers fail to comply with the requirements set forth above."

(g) Definition of "Expiration Date." Substitute "July 12, 2007" for "July 22, 2005" in clause (a) of the definition of "Expiration Date."

(h) Definition of "Facility Amount." Substitute "$145,000,000.00" for "$110,000,000.00" in the definition of "Facility Amount."

(i) Definition of "Guaranty." The definition of "Guaranty" is amended to read as follows:

"'Guaranty' means a guaranty agreement in form and substance acceptable to Administrative Agent and the Banks, which has been executed by a Guarantor and delivered to Administrative Agent for the ratable benefit of the Banks and the Swap Banks."

(j) Definition of "In-the-Money Positions." Add the following definition of "In-the-Money Positions:"

"'In-the-Money Positions' means the Co-Borrowers' net in-the-money forward positions with counterparties; provided, however, that net in-the-money forward positions with a counterparty in excess of $750,000 (a) would constitute an Eligible Account in respect of the obligation of such counterparty if all amounts reflected in such in-the-money forward positions were due and payable presently, if all requirements to constitute Eligible Accounts have been fulfilled to the satisfaction of all of the Banks and if all of the Banks have granted all necessary pre-approvals and approvals to constitute Eligible Accounts, and (b) (i) shall be pre-approved by all the Banks in their sole discretion or (ii) secured by letters of credit in form acceptable to all the Banks in their sole discretion and issued by banks approved by all the Banks in their sole discretion."

(k) Definition of "L/C Sub-limit." Substitute "$50,000,000.00" for "$30,000,000.00" in the definition of "L/C Sub-limit."

(l) Definition of "Maturity Date." Substitute "July 10, 2009" for "July 23, 2007" in the definition of "Maturity Date."

(m) Definition of "Security Agreements." The definition of "Security Agreements" is amended to read as follows:

"'Security Agreements' means security agreements, in form and substance acceptable to Administrative Agent and the Banks, duly executed by each of the Co-Borrowers and delivered to Administrative Agent granting to the Collateral Agent for the ratable benefit of the Banks and the Swap Banks, a first prior security interest in and Lien upon the Collateral."

(n) Definition of "Swap Banks." The definition of "Swap Banks" is amended to read as follows:

"'Swap Banks' means BNP Paribas, Fortis, Natexis and their respective Affiliates in their capacity as a party to a Swap Contract."

2.2 Section 2.03 – Procedure for Borrowing.

(a) Section 2.03(a) is amended by adding the following sentence at the end of such Section:

"Each Notice of Borrowing for a Dollar Advance shall specify whether such advance is to be made in Dollars or Canadian dollars, and if such Notice of Borrowing requests a Base Rate Loan to be made in Canadian dollars, such Notice of Borrowing must be received by the Administrative Agent prior to 1:00 p.m. (New York City time) two (2) Business Days prior to the requested Borrowing Date."

(b) Section 2.03(c) is amended by adding the following sentence at the end of such Section:

"If a Dollar Advance is made in Canadian dollars, each Bank will make available to the Administrative Agent its Pro Rata Share of such advance in Canadian dollars."

2.3 Section 2.07 – Repayment. Section 2.07 is amended by adding the following sentence at the end of such Section:

"Each Dollar Advance made in Canadian dollars shall be repaid by the Co-Borrowers in Canadian dollars."

2.4 Section 2.08 – Interest. Section 2.08 is amended by adding subsection 2.08(f) as follows:

"(f) Notwithstanding any other provision in this Section 2.08, each Dollar Advance that is made in Canadian dollars shall bear interest on the outstanding principal amount thereof from the applicable Borrowing Date at a rate per annum equal to the following:

(i) the Base Rate plus 1.50%. For purposes of Dollar Advances in Canadian dollars, the 'Base Rate' shall mean the BNP Paribas cost of funds for Canadian dollars, or

(ii) the Eurodollar Rate plus 1.50%. For purposes of Dollar Advances in Canadian dollars, the 'Eurodollar Rate' shall be calculated in the same manner as for Dollars, except

that the term ‘Dollars’ in the definition of ‘Eurodollar Rate’ shall refer to Canadian dollars.

Except as provided above, the provisions in this Agreement relating to the election, calculation and payment of interest shall apply to Dollar Advances made in Canadian dollars.”

2.5 Section 2.14 – Payments from Guarantors and Liquidation of Collateral. Section 2.14 is amended to read as follows:

“2.14 Payments from Guarantors and Liquidation of Collateral. Notwithstanding anything to the contrary contained herein, in the event that a Default has occurred and is continuing and repayment is made to the Banks and the Swap Banks by the Guarantors or made pursuant to a liquidation of Collateral, whether by setoff or otherwise, such repayment shall be shared by the Banks and the Swap Banks on the basis of each Bank’s then existing Adjusted Pro Rata Share rather than each Bank’s Pro Rata Share. If Required Banks declare a Default or Event of Default, the Swap Banks upon vote of the Required Banks immediately shall terminate all Swap Contracts. Following such termination or termination of all Swap Contracts by the Swap Banks on their own initiative, no distribution shall be made to the Banks before establishing the Adjusted Pro Rata Shares of all the Banks taking into account the Obligations to the Swap Banks under the Swap Contracts, including Obligations arising as a result of such termination. If the Required Banks do not vote to cause the termination of the Swap Contracts, after all such repayments are made to the Banks by the Guarantors or made pursuant to such liquidation of Collateral, the total amount received by any Bank from all such payments or repayments following such declaration of a Default exceeds such Bank’s Aggregate Credit Exposure Percentage of all such payments or repayments, then the Banks shall purchase participations in each other’s Obligations so that after giving effect to such purchases of participations, each Bank shall have received its Aggregate Credit Exposure Percentage of all such payments or repayments.”

2.6 Section 7.02(b) – Certificates; Other Information. The proviso beginning on line six of Section 7.02(b) is amended to read as follows:

“provided, that upon the occurrence and during the continuation of the amount of the difference between (i) the sum of the amounts listed in subsection (b) of the definition of “Borrowing Base Cap” and (ii) total outstandings under the Borrowing Base Line being less than $25,000,000, a Borrowing Base Report shall be required weekly, on Wednesday of each week as of Friday of the preceding week and on the 6th calendar day of each month as of the last calendar day of the preceding month, in each case executed by a Responsible Officer of the Co-Borrowers (provided (i) the Administrative Agent may, in its sole discretion or at the request of any Bank, waive the requirement that a Borrowing Base Report be furnished on a weekly basis or reinstate such requirement following a waiver thereof, (ii) the Co-Borrowers shall have no duty to deliver two Borrowing Base Reports in the same calendar week and if as a result of month end two such reports would be due during the same calendar week, the Co-Borrowers shall not be required to deliver a weekly report for the last Friday of such month, and (iii) the Co-Borrowers shall have no duty to deliver a Borrowing Base Report if on the reporting date under this subsection (b) there has been no utilization of the Borrowing Base Line).”

2.7 Section 8.11 – Value at Risk of Open Positions. Section 8.11 is amended as follows:

Subsection (a): Substitute “$6,900,000.00” for “$5,200,000.00”.

Subsection (b): Substitute “$6,000,000.00” for “$4,500,000.00”.

Subsection (c): Substitute “$4,800,000.00” for “$3,600,000.00”.

2.8 Section 8.12(a) – Consolidated Financial Covenants. Section 8.12(a) is amended to substitute “$20,700,000.00” for “$15,600,000.00”.

2.9 Section 8.15(d) – Loans and Investments. Section 8.15 is amended as follows:

(a) Add paragraph (d)(i) as follows:

“(i) The long-term indebtedness of Avista Corporation is rated at least BB+ or the equivalent thereof by Standard & Poor’s Ratings Group, a division of McGraw-Hill, Inc., or Ba1 or the equivalent thereof by Moody’s Investors Services, Inc.

(b) Change the following paragraph designations:

From	to
(d) (i)	(d) (ii)
(d) (ii)	(d) (iii)
(d) (iii)	(d) (iv)
(d) (v)	(d) (vi)

2.10 Section 9.01 – Event of Default. Section 9.01 is amended as follows:

(a) Subsection (l): Substitute "$150,000,000.00" for "$160,000,000.00."

(b) Subsection (n): Deleted in its entirety.

2.11 Section 10.12 – Swap Banks. Section 10.12 is added to the Credit Agreement as follows:

"10.12 Swap Banks. To the extent any Affiliate of a Bank is a party to a Swap Contract with the Co-Borrowers and thereby becomes a beneficiary of the Liens pursuant to the Security Agreements, such Affiliate of a Bank shall be deemed to appoint the Collateral Agent its nominee and agent, to act for and on behalf of such Affiliate in connection with the Security Agreements and the Collateral and to be bound by the terms of this Article X."

2.12 Schedules.

(a) Schedule 2.01 (Line Portions) to the Credit Agreement is deleted and replaced with Schedule 2.01 attached hereto.

(b) Schedule 6.05 (Litigation) to the Credit Agreement is deleted and replaced with Schedule 6.05 attached hereto.

(c) Schedule 8.01 (Permitted Indebtedness and Liens) to the Credit Agreement is deleted and replaced with Schedule 8.01 attached hereto.

(d) Schedule 8.06 (Contingent Obligations) to the Credit Agreement is deleted and replaced with Schedule 8.06 attached hereto.

(e) Schedule 8.09 (Lines of Business, Trading Strategies, Policies and Procedures) to the Credit Agreement is deleted and replaced with Schedule 8.09 attached hereto.

2.13 Exhibits.

(a) Exhibit E (Form of Borrowing Base Report) to the Credit Agreement is deleted and replaced with Exhibit E attached hereto.

(b) Exhibit H (Volumetric Limits):

(i) substitute "36 months" for "24 months" each time the latter appears in Exhibit H;
(ii) revise the 7th box from the top of Exhibit H to read as follows:

"Net Open Power Positions collectively at all Hubs over next 36 months	200 aMW over 36 months (5.3 million MWh)"

3. **Effectiveness of Amendment**. This Amendment shall be effective upon receipt by the Banks of:

(a) An executed copy of this Amendment;

(b) A Confirmation of Guaranty, in the form attached hereto, signed by each of the Guarantors;

(c) An executed copy of the Amendment of Security Agreements;

(d) An executed copy of promissory notes issued to each of the Banks;

(e) Payment of all fees owing to the Banks, pursuant to the fee letters from Borrowers to each of the Banks executed in connection herewith;

(f) Resolutions from each of the Borrowers and each of the Guarantors, in form and substance satisfactory to the Banks, authorizing the execution and delivery of and performance under this Amendment and any documents or agreements entered into in connection therewith; and

(g) Such other documents and instruments as any Bank may reasonably request to reflect the changes set forth in this Amendment.

4. **Ratifications, Representations and Warranties**.

(a) The terms and provisions set forth in this Amendment shall modify and supersede all inconsistent terms and provisions set forth in the Credit Agreement and, except as expressly modified and superseded by this Amendment, the terms and provisions of the Credit Agreement are ratified and confirmed and shall continue in full force and effect. The Borrowers and the Banks agree that the Credit Agreement and the Loan Documents, as amended hereby, shall continue to be legal, valid, binding and enforceable in accordance with their respective terms.

(b) To induce the Banks to enter into this Amendment, each Borrower ratifies and confirms each representation and warranty set forth in the Credit Agreement as if such representations and warranties were made on the even date herewith, and further represents and warrants (i) that there has occurred since the date of the last financial statements delivered to the Banks no event or circumstance that has resulted or could reasonably be expected to result in a Material Adverse Effect, (ii) that no Event of Default exists on the date hereof, and (iii) that each Borrower is fully authorized to enter into this Amendment.

5. Benefits. This Amendment shall be binding upon and inure to the benefit of each Bank and each Borrower, and their respective successors and assigns; provided, however, that neither Borrower may, without the prior written consent of the Banks, assign any rights, powers, duties or obligations under this Amendment, the Credit Agreement, the Security Agreements or any of the other Loan Documents.

6. Construction. This Amendment shall be governed by and construed in accordance with the laws (without reference to principles of conflicts of laws) of the State of New York, provided that the Banks shall retain all rights arising under federal law.

7. Invalid Provisions. If any provision of this Amendment is held to be illegal, invalid or unenforceable under present or future laws, such provision shall be fully severable and the remaining provisions of this Amendment shall remain in full force

and effect and shall not be affected by the illegal, invalid or unenforceable provision or by its severance.

8. Entire Agreement. The Credit Agreement, as amended by this Amendment, along with the other Loan Documents, contain the entire agreement among the parties regarding the subject matter hereof and supersede all prior written and oral agreements and understandings among the parties hereto regarding same.

9. Reference to Credit Agreement. The Credit Agreement and any and all other agreements, documents or instruments now or hereafter executed and delivered pursuant to the terms hereof or pursuant to the terms of the Credit Agreement, as amended hereby, are hereby amended so that any reference in the Credit Agreement or the other Loan Documents to the Credit Agreement shall mean a reference to the Credit Agreement, as amended hereby.

10. Counterparts. This Amendment may be separately executed in any number of counterparts, each of which shall be an original, but all of which, taken together, shall be deemed to constitute one and the same agreement.

[remainder of page intentionally left blank; signature pages follow]

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed and delivered by their proper and duly authorized officers as of the day and year first above written.

AVISTA ENERGY, INC.,
a Washington corporation

By: /s/ Dennis P. Vermillion
Name: Dennis P. Vermillion
Title: President & COO

AVISTA ENERGY CANADA LTD.,
a corporation of the province of
Alberta, Canada

By: /s/ Dennis P. Vermillion
Name: Dennis P. Vermillion
Title: President & COO

Borrowers' Address:
201 W. North River Drive
Suite 610
Spokane, Washington 99201
Attention: Dennis Vermillion
Telephone: (509) 688-6000
Facsimile: (509) 688-6154
E-mail: dennis.vermillion@avistaenergy.com

BNP PARIBAS,
as Administrative Agent, Collateral Agent, an Issuing Bank, and a Bank

By: /s/ Jordan Nenoff
Name: Jordan Nenoff
Title: Vice President

By: /s/ Richard J. Wernli
Name: Richard J. Wernli
Title: Director

787 Seventh Avenue
New York, NY 10019
Attention: Jordan Nenoff
Phone: 212-841-2575
Fax: 212-841-2536
E-mail: Jordan.nenoff@ americas.bnpparibas.com

FORTIS CAPITAL CORP.,
as Documentation Agent, an Issuing Bank, and a Bank

By: /s/ Irene C. Rummel
Name: Irene C. Rummel
Title: Senior Vice President

By: /s/ Leonard Russo
Name: Leonard Russo
Title: Director

15455 North Central Parkway
Suite 1400
Addison, TX 7501
Attention: Irene Rummel
Phone: 214-953-9313
Fax: 214-969-9332
E-mail: irene.rummel@fortiscapitalusa.com

NATEXIS BANQUES POPULAIRES
as a Bank

By: /s/ David Pershad
Name: David Pershad
Title: Vice President

By: /s/ Stephen A. Jendras
Name: Stephen A. Jendras
Title: Vice President

1251 Avenue of the Americas
34th Floor
New York, NY 10020
Attention: David Pershad
Phone: 212-872-5015
Fax: 212-354-9095
E-mail: david.pershad@nyc.nxbp.com

AVISTA CORPORATION

Computation of Ratio of Earnings to Fixed Charges and Preferred Dividend Requirements
Consolidated
(Thousands of Dollars)

	12 months ended June 30, 2005	Years Ended December 31			
		2004	2003	2002	2001
Fixed charges, as defined:					
Interest expense	$ 83,792	$ 84,746	$ 85,013	$ 96,005	$ 100,180
Amortization of debt expense and premium - net	8,173	8,301	7,972	8,861	5,639
Interest portion of rentals	1,912	2,443	4,452	6,140	5,140
Total fixed charges	$ 93,877	$ 95,490	$ 97,437	$ 111,006	$ 110,959
Earnings, as defined:					
Income from continuing operations	$ 41,591	$ 35,614	$ 50,643	$ 42,174	$ 68,241
Add (deduct):					
Income tax expense	23,206	21,592	35,340	34,849	40,585
Total fixed charges above	93,877	95,490	97,437	111,006	110,959
Total earnings	$ 158,674	$ 152,696	$ 183,420	$ 188,029	$ 219,785
Ratio of earnings to fixed charges	1.69	1.60	1.88	1.69	1.98
Fixed charges and preferred dividend requirements:					
Fixed charges above	$ 93,877	$ 95,490	$ 97,437	$ 111,006	$ 110,959
Preferred dividend requirements (1)	—	—	1,910	4,387	3,878
Total	$ 93,877	$ 95,490	$ 99,347	$ 115,393	$ 114,837
Ratio of earnings to fixed charges and preferred dividend requirements	1.69	1.60	1.85	1.63	1.91

(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 18

July 27, 2005

Avista Corporation
1411 East Mission
Spokane, Washington 99220

Dear Sirs/Madams:

At your request, we have read the description included in your Quarterly Report on Form 10-Q to the Securities and Exchange Commission for the quarter ended June 30, 2005, of the facts relating to the change in the date of the annual impairment test under Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, from March 31st to November 30th. We believe, on the basis of the facts so set forth and other information furnished to us by appropriate officials of the Company, that the accounting change described in your Form 10-Q is to an alternative accounting principle that is preferable under the circumstances.

We have not audited any consolidated financial statements of Avista Corporation and its consolidated subsidiaries as of any date or for any period subsequent to December 31, 2004. Therefore, we are unable to express, and we do not express, an opinion on the facts set forth in the above-mentioned Form 10-Q, on the related information furnished to us by officials of the Company, or on the financial position, results of operations, or cash flows of Avista Corporation and its consolidated subsidiaries as of any date or for any period subsequent to December 31, 2004.

Yours truly,

/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: August 5, 2005

/s/ Gary G. Ely
Gary G. Ely
Chairman of the Board, President 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: August 5, 2005

/s/ Malyn K. Malquist
Malyn K. Malquist
Senior Vice President,
Chief Financial Officer and Treasurer
(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, President and Chief Executive Officer of Avista Corporation (the "Company"), and Malyn K. Malquist, Senior Vice President, Chief Financial Officer and Treasurer 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 June 30, 2005 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: August 5, 2005

/s/ Gary G. Ely
Gary G. Ely
Chairman of the Board,
President and Chief Executive Officer

/s/ Malyn K. Malquist
Malyn K. Malquist
Senior Vice President,
Chief Financial Officer and Treasurer