

---

---

**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, 2012

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**  
(State or other jurisdiction of  
incorporation or organization)

**91-0462470**  
(I.R.S. Employer  
Identification No.)

**1411 East Mission Avenue, Spokane, Washington**  
(Address of principal executive offices)

**99202-2600**  
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes  No

As of July 31, 2012, 58,769,670 shares of Registrant's Common Stock, no par value (the only class of common stock), were outstanding.

---

---

## Table of Contents

### AVISTA CORPORATION Index

Page No.

#### Part I. Financial Information:

Item 1.	Condensed Consolidated Financial Statements	
	<a href="#">Condensed Consolidated Statements of Income - Three Months Ended June 30, 2012 and 2011</a>	5
	<a href="#">Condensed Consolidated Statements of Income - Six Months Ended June 30, 2012 and 2011</a>	6
	<a href="#">Condensed Consolidated Statements of Comprehensive Income - Three and Six Months Ended June 30, 2012 and 2011</a>	7
	<a href="#">Condensed Consolidated Balance Sheets - June 30, 2012 and December 31, 2011</a>	8
	<a href="#">Condensed Consolidated Statements of Cash Flows - Six Months Ended June 30, 2012 and 2011</a>	10
	<a href="#">Condensed Consolidated Statements of Equity and Redeemable Noncontrolling Interests - Six Months Ended June 30, 2012 and 2011</a>	11
	<a href="#">Notes to Condensed Consolidated Financial Statements</a>	12
	<a href="#">Report of Independent Registered Public Accounting Firm</a>	35
Item 2.	<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	36
Item 3.	<a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	58
Item 4.	<a href="#">Controls and Procedures</a>	59

#### Part II. Other Information:

Item 1.	<a href="#">Legal Proceedings</a>	60
Item 1A.	<a href="#">Risk Factors</a>	60
Item 4.	<a href="#">Mine Safety Disclosures</a>	60
Item 6.	<a href="#">Exhibits</a>	60

<a href="#">Signature</a>		61
---------------------------	--	----

## FORWARD-LOOKING STATEMENTS

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

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

These statements have underlying assumptions (many of which are based, in turn, upon further assumptions). Such statements are made both in our reports filed under the Securities Exchange Act of 1934, as amended (including this Quarterly Report on Form 10-Q), and elsewhere. Forward-looking statements are all statements except those of historical fact including, without limitation, those that are identified by the use of words that include “will,” “may,” “could,” “should,” “intends,” “plans,” “seeks,” “anticipates,” “estimates,” “expects,” “forecasts,” “projects,” “predicts,” and similar expressions. Forward-looking statements (including those made in this Quarterly Report on Form 10-Q) are subject to a variety of risks and uncertainties and other factors. Many of these factors are beyond our control and they could have a significant effect on our operations, results of operations, financial condition or cash flows. This could cause actual results to differ materially from those anticipated in our statements. Such risks, uncertainties and other factors include, among others:

- weather conditions (temperatures, precipitation levels and wind patterns) and their effects on energy demand and electric generation, including the effect of precipitation and temperatures on the availability of hydroelectric resources, the effect of wind patterns on the availability of wind resources, the effect of temperatures on customer demand, and similar impacts on supply and demand in the wholesale energy markets;
- the effect of state and federal regulatory decisions on our ability to recover costs and earn a reasonable return including, but not limited to, the disallowance of costs and investments, and delay in the recovery of capital investments and operating costs;
- changes in wholesale energy prices that can affect, among other things, the cash requirements to purchase electricity and natural gas, the value received for sales in the wholesale energy market, the necessity to request changes in rates that are subject to regulatory approval, collateral required of us by counterparties on wholesale energy transactions and credit risk to us from such transactions, and the market value of derivative assets and liabilities;
- economic conditions in our service areas, including the effect on the demand for, and customers’ payment for, our utility services;
- global financial and economic conditions (including the impact on capital markets) and their effect on our ability to obtain funding at a reasonable cost;
- our ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including our credit ratings, interest rates and other capital market conditions;
- the potential effects of legislation or administrative rulemaking, including the possible adoption of national or state laws requiring our resources to meet certain standards and placing restrictions on greenhouse gas emissions to mitigate concerns over global climate changes;
- changes in actuarial assumptions, interest rates and the actual return on plan assets for our pension plan, which can affect future funding obligations, pension expense and pension plan liabilities;
- volatility and illiquidity in wholesale energy markets, including the availability of willing buyers and sellers, and prices of purchased energy and demand for energy sales;
- unplanned outages at any of our generating facilities or the inability of facilities to operate as intended;
- the outcome of pending regulatory and legal proceedings arising out of the “western energy crisis” of 2000 and 2001, including possible refunds;
- the outcome of legal proceedings and other contingencies;
- changes in, and compliance with, environmental and endangered species laws, regulations, decisions and policies, including present and potential environmental remediation costs;
- wholesale and retail competition including, but not limited to, alternative energy sources, suppliers and delivery arrangements;
- the ability to comply with the terms of the licenses for our hydroelectric generating facilities at cost-effective levels;
- natural disasters that can disrupt energy generation, transmission and distribution, as well as the availability and costs of materials, equipment, supplies and support services;
- explosions, fires, accidents, or mechanical breakdowns that may occur while operating and maintaining our generation, transmission and distribution systems;
- blackouts or disruptions of interconnected transmission systems;
- disruption to information systems, automated controls and other technologies that we rely on for operations, communications and customer service;

## Table of Contents

- the potential for terrorist attacks, cyber security attacks or other malicious acts, that cause damage to our utility assets, as well as the national economy in general; including the impact of acts of terrorism, cyber security attacks or vandalism that damage or disrupt information technology systems;
- delays or changes in construction costs, and/or our ability to obtain required permits and materials for present or prospective facilities;
- changes in the costs to implement new information technology systems, and/or other reasons that impair our ability to complete these projects in a timely and effective manner;
- changes in the long-term climate of the Pacific Northwest, which can affect, among other things, customer demand patterns and the volume and timing of streamflows to our hydroelectric resources;
- changes in industrial, commercial and residential growth and demographic patterns in our service territory or the loss of significant customers;
- the loss of key suppliers for materials or services;
- default or nonperformance on the part of any parties from which we purchase and/or sell capacity or energy;
- deterioration in the creditworthiness of our customers and counterparties;
- the effect of any potential decline in our credit ratings, including impeded access to capital markets, higher interest costs, and certain covenants with ratings triggers in our financing arrangements and wholesale energy contracts;
- increasing health care costs and the resulting effect on health insurance provided to our employees and retirees;
- increasing costs of insurance, more restricted coverage terms and our ability to obtain insurance;
- work force issues, including changes in collective bargaining unit agreements, strikes, work stoppages, the loss of key executives, availability of workers in a variety of skill areas, and our ability to recruit and retain employees;
- the potential effects of negative publicity regarding business practices, whether true or not, which could result in, among other things, costly litigation and a decline in our common stock price;
- changes in technologies, possibly making some of the current technology obsolete;
- changes in tax rates and/or policies;
- changes in the payment acceptance policies of Ecova's client vendors that could reduce operating revenues;
- potential difficulties for Ecova in integrating acquired operations and in realizing expected opportunities, diversions of management resources and losses of key employees, challenges with respect to operating new businesses and other unanticipated risks and liabilities; and
- changes in our strategic business plans, which may be affected by any or all of the foregoing, including the entry into new businesses and/or the exit from existing businesses.

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Three Months Ended June 30

Dollars in thousands, except per share amounts

(Unaudited)

	2012	2011
<b>Operating Revenues:</b>		
Utility revenues	\$ 293,315	\$ 319,973
Non-utility revenues	50,270	40,584
Total operating revenues	<u>343,585</u>	<u>360,557</u>
<b>Operating Expenses:</b>		
Utility operating expenses:		
Resource costs	135,992	155,776
Other operating expenses	63,601	68,700
Depreciation and amortization	27,754	26,407
Taxes other than income taxes	20,390	19,699
Non-utility operating expenses:		
Other operating expenses	43,978	32,609
Depreciation and amortization	3,571	1,842
Total operating expenses	<u>295,286</u>	<u>305,033</u>
Income from operations	48,299	55,524
Interest expense	19,188	18,272
Interest expense to affiliated trusts	137	152
Capitalized interest	(596)	(814)
Other expense-net	678	803
Income before income taxes	28,892	37,111
Income tax expense	10,360	13,583
Net income	18,532	23,528
Net income attributable to noncontrolling interests	(354)	(527)
Net income attributable to Avista Corporation	<u>\$ 18,178</u>	<u>\$ 23,001</u>
Weighted-average common shares outstanding (thousands), basic	58,702	57,787
Weighted-average common shares outstanding (thousands), diluted	58,924	58,143
<b>Earnings per common share attributable to Avista Corporation:</b>		
Basic	<u>\$ 0.31</u>	<u>\$ 0.40</u>
Diluted	<u>\$ 0.31</u>	<u>\$ 0.39</u>
Dividends paid per common share	<u>\$ 0.29</u>	<u>\$ 0.275</u>

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Six Months Ended June 30

Dollars in thousands, except per share amounts

(Unaudited)

	2012	2011
<b>Operating Revenues:</b>		
Utility revenues	\$698,775	\$757,670
Non-utility revenues	97,067	79,473
Total operating revenues	795,842	837,143
<b>Operating Expenses:</b>		
Utility operating expenses:		
Resource costs	347,004	403,897
Other operating expenses	126,958	128,382
Depreciation and amortization	55,072	52,259
Taxes other than income taxes	45,532	44,692
Non-utility operating expenses:		
Other operating expenses	87,680	63,855
Depreciation and amortization	6,575	3,709
Total operating expenses	668,821	696,794
Income from operations	127,021	140,349
Interest expense	38,325	36,712
Interest expense to affiliated trusts	277	303
Capitalized interest	(1,121)	(1,252)
Other expense-net	1,297	1,435
Income before income taxes	88,243	103,151
Income tax expense	31,498	37,220
Net income	56,745	65,931
Net income attributable to noncontrolling interests	(179)	(1,012)
Net income attributable to Avista Corporation	\$ 56,566	\$ 64,919
Weighted-average common shares outstanding (thousands), basic	58,642	57,565
Weighted-average common shares outstanding (thousands), diluted	58,937	57,780
<b>Earnings per common share attributable to Avista Corporation:</b>		
Basic	\$ 0.96	\$ 1.13
Diluted	\$ 0.96	\$ 1.12
Dividends paid per common share	\$ 0.58	\$ 0.55

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Avista Corporation

For the Three Months Ended June 30

Dollars in thousands

(Unaudited)

	<u>2012</u>	<u>2011</u>
Net income	\$18,532	\$23,528
Other Comprehensive Income:		
Unrealized investment gains - net of taxes of \$137	230	—
Reclassification adjustment for realized gains on investment securities included in net income - net of taxes of \$(78)	(130)	—
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$91 and \$33, respectively	168	60
Total other comprehensive income	268	60
Comprehensive income	18,800	23,588
Comprehensive income attributable to noncontrolling interests	(354)	(527)
Comprehensive income attributable to Avista Corporation	<u>\$18,446</u>	<u>\$23,061</u>

For the Six Months Ended June 30

Dollars in thousands

(Unaudited)

	<u>2012</u>	<u>2011</u>
Net income	\$56,745	\$65,931
Other Comprehensive Income (Loss):		
Unrealized investment gains - net of taxes of \$176	299	—
Reclassification adjustment for realized gains on investment securities included in net income - net of taxes of \$(83)	(141)	—
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$173 and \$(73), respectively	321	(136)
Total other comprehensive income (loss)	479	(136)
Comprehensive income	57,224	65,795
Comprehensive income attributable to noncontrolling interests	(179)	(1,012)
Comprehensive income attributable to Avista Corporation	<u>\$57,045</u>	<u>\$64,783</u>

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED BALANCE SHEETS

Avista Corporation

Dollars in thousands  
(Unaudited)

	June 30, 2012	December 31, 2011
<b>Assets:</b>		
Current Assets:		
Cash and cash equivalents	\$ 93,416	\$ 74,662
Accounts and notes receivable-less allowances of \$44,582 and \$43,958	148,079	203,452
Utility energy commodity derivative assets	1,345	1,139
Regulatory asset for utility derivatives	61,479	69,685
Investments and funds held for clients	129,079	118,536
Materials and supplies, fuel stock and natural gas stored	51,137	52,006
Deferred income taxes	36,711	30,473
Income taxes receivable	5,548	15,378
Other current assets	28,571	49,225
Total current assets	<u>555,365</u>	<u>614,556</u>
Net Utility Property:		
Utility plant in service	3,964,150	3,887,384
Construction work in progress	92,649	79,322
Total	<u>4,056,799</u>	<u>3,966,706</u>
Less: Accumulated depreciation and amortization	<u>1,146,481</u>	<u>1,105,930</u>
Total net utility property	<u>2,910,318</u>	<u>2,860,776</u>
Other Non-current Assets:		
Investment in exchange power-net	17,558	18,783
Investment in affiliated trusts	11,547	11,547
Goodwill	73,783	39,045
Long-term energy contract receivable of Spokane Energy	57,390	62,525
Other intangibles, property and investments-net	92,116	80,309
Total other non-current assets	<u>252,394</u>	<u>212,209</u>
Deferred Charges:		
Regulatory assets for deferred income tax	79,262	84,576
Regulatory assets for pensions and other postretirement benefits	252,312	260,359
Other regulatory assets	106,905	119,738
Non-current utility energy commodity derivative assets	464	185
Non-current regulatory asset for utility derivatives	33,918	40,345
Other deferred charges	25,417	21,787
Total deferred charges	<u>498,278</u>	<u>526,990</u>
Total assets	<u>\$4,216,355</u>	<u>\$4,214,531</u>

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

Avista Corporation

Dollars in thousands

(Unaudited)

	June 30, 2012	December 31, 2011
<b>Liabilities and Equity:</b>		
Current Liabilities:		
Accounts payable	\$ 148,734	\$ 166,954
Client fund obligations	128,599	118,325
Current portion of long-term debt	423	7,474
Current portion of nonrecourse long-term debt of Spokane Energy	14,304	13,668
Short-term borrowings	91,000	96,000
Utility energy commodity derivative liabilities	55,027	70,824
Natural gas deferrals	16,175	12,140
Other current liabilities	130,387	141,789
Total current liabilities	<u>584,649</u>	<u>627,174</u>
Long-term debt	1,147,765	1,169,826
Nonrecourse long-term debt of Spokane Energy	25,474	32,803
Long-term debt to affiliated trusts	51,547	51,547
Long-term borrowings under committed line of credit	60,000	—
Regulatory liability for utility plant retirement costs	229,885	227,282
Pensions and other postretirement benefits	225,250	246,177
Deferred income taxes	517,568	505,954
Other non-current liabilities and deferred credits	104,379	116,084
Total liabilities	<u>2,946,517</u>	<u>2,976,847</u>
Commitments and Contingencies (See Notes to Condensed Consolidated Financial Statements)		
Redeemable Noncontrolling Interests	<u>53,424</u>	<u>51,809</u>
Equity:		
Avista Corporation Stockholders' Equity:		
Common stock, no par value; 200,000,000 shares authorized; 58,757,935 and 58,422,781 shares outstanding	861,053	855,188
Accumulated other comprehensive loss	(5,158)	(5,637)
Retained earnings	360,947	336,150
Total Avista Corporation stockholders' equity	1,216,842	1,185,701
Noncontrolling Interests	(428)	174
Total equity	<u>1,216,414</u>	<u>1,185,875</u>
Total liabilities and equity	<u>\$4,216,355</u>	<u>\$4,214,531</u>

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

[Table of Contents](#)

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Avista Corporation

For the Six Months Ended June 30

Dollars in thousands

(Unaudited)

	2012	2011
<b>Operating Activities:</b>		
Net income	\$ 56,745	\$ 65,931
Non-cash items included in net income:		
Depreciation and amortization	61,647	55,968
Provision for deferred income taxes	6,522	5,158
Power and natural gas cost amortizations, net	8,822	4,149
Amortization of debt expense and premium	1,926	2,217
Equity-related AFUDC	(1,748)	(1,235)
Other	33,348	21,753
Contributions to defined benefit pension plan	(29,400)	(17,250)
Changes in working capital components:		
Accounts and notes receivable	55,719	65,736
Materials and supplies, fuel stock and natural gas stored	869	935
Other current assets	15,694	2,147
Accounts payable	(3,456)	(39,034)
Other current liabilities	(6,971)	(3,023)
Net cash provided by operating activities	<u>199,717</u>	<u>163,452</u>
<b>Investing Activities:</b>		
Utility property capital expenditures (excluding equity-related AFUDC)	(120,476)	(98,882)
Other capital expenditures	(2,266)	(1,600)
Federal grant payments received	4,483	6,824
Cash paid by subsidiaries for acquisitions, net of cash received	(50,310)	(199)
Decrease (increase) in funds held for clients	(16,424)	33,439
Purchase of securities available for sale	(64,850)	—
Sale and maturity of securities available for sale	71,492	—
Other	(4,158)	(3,561)
Net cash used in investing activities	<u>(182,509)</u>	<u>(63,979)</u>
<b>Financing Activities:</b>		
Net increase (decrease) in short-term borrowings	30,000	(35,000)
Borrowings from Ecova line of credit	25,000	—
Redemption and maturity of long-term debt	(11,264)	(189)
Maturity of nonrecourse long-term debt of Spokane Energy	(6,694)	(6,104)
Long-term debt and short-term borrowing issuance costs	(130)	(2,348)
Cash paid for settlement of interest rate swap agreements	(18,547)	—
Issuance of common stock	3,575	15,878
Cash dividends paid	(34,101)	(31,729)
Purchase of subsidiary noncontrolling interest	(784)	(6,054)
Increase (decrease) in client fund obligations	9,764	(33,439)
Issuance of subsidiary noncontrolling interests	3,714	—
Other	1,013	15
Net cash provided by (used in) financing activities	<u>1,546</u>	<u>(98,970)</u>
Net increase in cash and cash equivalents	18,754	503
Cash and cash equivalents at beginning of period	<u>74,662</u>	<u>69,413</u>
Cash and cash equivalents at end of period	<u>\$ 93,416</u>	<u>\$ 69,916</u>
<b>Supplemental Cash Flow Information:</b>		
Cash paid during the period:		
Interest	\$ 36,277	\$ 34,462
Income taxes	12,217	22,650
Non-cash financing and investing activities:		
Accounts payable for capital expenditures	4,381	4,218
Redeemable noncontrolling interests	(3,031)	6,754

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

[Table of Contents](#)CONDENSED CONSOLIDATED STATEMENTS OF EQUITY  
AND REDEEMABLE NONCONTROLLING INTERESTS

Avista Corporation

For the Six Months Ended June 30

Dollars in thousands

(Unaudited)

	2012	2011
<b>Common Stock, Shares:</b>		
Shares outstanding at beginning of period	58,422,781	57,119,723
Issuance of common stock	335,154	858,187
Shares outstanding at end of period	<u>58,757,935</u>	<u>57,977,910</u>
<b>Common Stock, Amount:</b>		
Balance at beginning of period	\$ 855,188	\$ 827,592
Equity compensation expense	2,241	1,804
Issuance of common stock, net of issuance costs	3,575	15,878
Equity transactions of consolidated subsidiaries	49	(3,220)
Balance at end of period	<u>861,053</u>	<u>842,054</u>
<b>Accumulated Other Comprehensive Loss:</b>		
Balance at beginning of period	(5,637)	(4,326)
Other comprehensive income (loss)	479	(136)
Balance at end of period	<u>(5,158)</u>	<u>(4,462)</u>
<b>Retained Earnings:</b>		
Balance at beginning of period	336,150	302,518
Net income attributable to Avista Corporation	56,566	64,919
Cash dividends paid (common stock)	(34,101)	(31,729)
Valuation adjustments and other noncontrolling interests activity	2,332	(5,165)
Balance at end of period	<u>360,947</u>	<u>330,543</u>
<b>Total Avista Corporation stockholders' equity</b>	<u>1,216,842</u>	<u>1,168,135</u>
<b>Noncontrolling Interests:</b>		
Balance at beginning of period	174	(600)
Net income attributable to noncontrolling interests	71	79
Deconsolidation of variable interest entity	(673)	—
Other	—	(26)
Balance at end of period	<u>(428)</u>	<u>(547)</u>
<b>Total equity</b>	<u>\$ 1,216,414</u>	<u>\$ 1,167,588</u>
<b>Redeemable Noncontrolling Interests:</b>		
Balance at beginning of period	\$ 51,809	\$ 46,722
Net income attributable to noncontrolling interests	108	933
Issuance of subsidiary noncontrolling interests	3,714	—
Purchase of subsidiary noncontrolling interests	(784)	(6,054)
Valuation adjustments and other noncontrolling interests activity	(1,423)	10,766
Balance at end of period	<u>\$ 53,424</u>	<u>\$ 52,367</u>

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

**AVISTA CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

The accompanying condensed consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended June 30, 2012 and 2011 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results for the interim periods. The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The Condensed Consolidated Statements of Income for the interim periods are not necessarily indicative of the results to be expected for the full year. These condensed 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, 2011 (2011 Form 10-K). Please refer to the section "Acronyms and Terms" in the 2011 Form 10-K for definitions of terms. The acronyms and terms are an integral part of these condensed consolidated financial statements.

**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 Montana and northern Oregon. Avista Utilities also provides natural gas distribution service in parts of eastern Washington and northern Idaho, as well as parts of northeast and southwest Oregon. Avista Capital, Inc. (Avista Capital), a wholly owned subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility businesses, except Spokane Energy, LLC (Spokane Energy). Avista Capital's subsidiaries include Ecova, Inc. (Ecova), a 79.0 percent owned subsidiary as of June 30, 2012. Ecova is a provider of energy efficiency and other facility information and cost management programs and services for multi-site customers and utilities throughout North America. See Note 12 for business segment information.

***Basis of Reporting***

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

***Taxes Other Than Income Taxes***

Taxes other than income taxes include state excise taxes, city occupational and franchise taxes, real and personal property taxes and certain other taxes not based on net income. These taxes are generally based on revenues or the value of property. Utility related taxes collected from customers (primarily state excise taxes and city utility taxes) are recorded as operating revenue and expense and totaled the following amounts for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Utility taxes	\$12,777	\$13,158	\$30,612	\$31,281

***Other Expense - Net***

Other expense - 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,	
	2012	2011	2012	2011
Interest income	\$ (363)	\$ (284)	\$ (638)	\$ (573)
Interest on regulatory deferrals	(16)	(23)	(24)	(68)
Equity-related AFUDC	(905)	(392)	(1,748)	(1,235)
Net loss on investments	88	140	527	37
Other expense	2,857	1,597	4,163	3,509
Other income	(983)	(235)	(983)	(235)
Total	\$ 678	\$ 803	\$ 1,297	\$ 1,435

**AVISTA CORPORATION**
**Investments and Funds Held for Clients and Client Fund Obligations**

In connection with the bill paying services, Ecova collects funds from its clients and remits the funds to the appropriate utility or other service provider. Some of the funds collected are invested by Ecova and classified as investments and funds held for clients and a related liability for client fund obligations is recorded. Investments and funds held for clients include cash and cash equivalent investments and investment securities classified as available for sale. Investments and funds held for clients as of June 30, 2012 are as follows (dollars in thousands):

	Amortized Cost	Unrealized Gain (Loss)	Fair Value
Cash and cash equivalents	\$ 38,933	\$ —	\$ 38,933
Securities available for sale:			
U.S. government agency	66,198	252	66,450
Municipal	8,673	53	8,726
Corporate fixed income – financial	6,562	63	6,625
Corporate fixed income – industrial	4,924	55	4,979
Corporate fixed income – utility	2,077	49	2,126
Certificates of deposit	1,250	(10)	1,240
Total securities available for sale	<u>89,684</u>	<u>462</u>	<u>90,146</u>
Total investments and funds held for clients	<u>\$128,617</u>	<u>\$ 462</u>	<u>\$129,079</u>

Investments and funds held for clients as of December 31, 2011 are as follows (dollars in thousands):

	Amortized Cost	Unrealized Gain (Loss)	Fair Value
Cash and cash equivalents	\$ 21,957	\$ —	\$ 21,957
Securities available for sale:			
U.S. government agency	74,721	172	74,893
Municipal	425	—	425
Corporate fixed income – financial	11,139	15	11,154
Corporate fixed income – industrial	6,495	23	6,518
Corporate fixed income – utility	2,088	4	2,092
Certificates of deposit	1,500	(3)	1,497
Total securities available for sale	<u>96,368</u>	<u>211</u>	<u>96,579</u>
Total investments and funds held for clients	<u>\$118,325</u>	<u>\$ 211</u>	<u>\$118,536</u>

Investments and funds held for clients are classified as a current asset since these funds are held solely for the purpose of satisfying the client fund obligations. Approximately 91 percent and 88 percent of the investment portfolio was rated AA or higher as of June 30, 2012 and December 31, 2011, respectively, by nationally recognized statistical rating organizations. All fixed income securities were rated at least investment grade as of June 30, 2012 and December 31, 2011.

Proceeds from sales, maturities and calls of securities available for sale were \$71.5 million for the six months ended June 30, 2012 with gross realized gains of \$0.1 million and there were not any gross realized losses. Proceeds from sales, maturities and calls of securities available for sale were \$44.5 million for the three months ended June 30, 2012 with gross realized gains of \$0.1 million and there were not any gross realized losses.

Contractual maturities of securities available for sale (at fair value) as of June 30, 2012 and December 31, 2011 are as follows (dollars in thousands):

	Due within 1 year	After 1 but within 5 years	After 5 but within 10 years	After 10 years	Total
June 30, 2012	\$ 2,478	\$25,780	\$55,711	\$6,177	\$90,146
December 31, 2011	425	55,126	41,028	—	96,579

Actual maturities may differ due to call or prepayment rights and the effective duration was 1.9 years as of June 30, 2012 and 1.3 years as of December 31, 2011.

**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. The Company completed its annual evaluation of goodwill for potential impairment as of November 30, 2011 for the other businesses and as of December 31, 2011 for Ecova and determined that goodwill was not impaired at that time. The changes in the carrying amount of goodwill are as follows (dollars in thousands):

	Ecova	Other	Accumulated Impairment Losses	Total
Balance as of December 31, 2011	\$33,799	\$12,979	\$ (7,733)	\$39,045
Goodwill acquired during the period	33,484	—	—	33,484
Adjustments	1,254	—	—	1,254
Balance as of the June 30, 2012	<u>\$68,537</u>	<u>\$12,979</u>	<u>\$ (7,733)</u>	<u>\$73,783</u>

**AVISTA CORPORATION**

Accumulated impairment losses are attributable to the other businesses. The goodwill acquired in 2012 was related to Ecova's acquisition of LPB Energy Management (LPB) effective January 31, 2012. The adjustment to goodwill recorded represents purchase accounting adjustments for Ecova's acquisition of Prenova based upon further review of the fair market values of relevant assets and liabilities identified as of the acquisition date.

**Other Intangibles**

Other Intangibles represent the amounts assigned to client relationships related to the Ecova acquisition of Cadence Network in 2008 (estimated amortization period of 12 years), Ecos in 2009 (estimated amortization period of 3 years), Loyaltan in 2010 (estimated amortization period of 6 years), Prenova in 2011 (estimated amortization period of 9 years) and LPB in 2012 (estimated amortization period of 3 to 10 years), software development costs (estimated amortization period of 3 to 7 years) and other. Other Intangibles are included in other intangibles, property and investments - net on the Condensed Consolidated Balance Sheets. Amortization expense related to Other Intangibles was as follows for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Other intangible amortization	\$2,558	\$1,264	\$4,655	\$2,153

The following table details the future estimated amortization expense related to Other Intangibles for each of the five years ending December 31 (dollars in thousands):

	2012	2013	2014	2015	2016
Estimated amortization expense	\$4,684	\$8,899	\$7,929	\$5,633	\$4,687

The gross carrying amount and accumulated amortization of Other Intangibles as of June 30, 2012 and December 31, 2011 are as follows (dollars in thousands):

	June 30, 2012	December 31, 2011
Client relationships	\$ 32,959	\$ 18,859
Software development costs	31,221	29,327
Other	5,348	3,065
Total other intangibles	69,528	51,251
Client relationships accumulated amortization	(5,771)	(3,623)
Software development costs accumulated amortization	(14,255)	(12,016)
Other accumulated amortization	(1,281)	(990)
Total accumulated amortization	(21,307)	(16,629)
Total other intangibles - net	\$ 48,221	\$ 34,622

**Derivative Assets and Liabilities**

Derivatives are recorded as either assets or liabilities on the Condensed Consolidated Balance Sheets measured at estimated fair value. 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.

The Washington Utilities and Transportation Commission (WUTC) and the Idaho Public Utilities Commission (IPUC) issued accounting orders authorizing Avista Utilities to offset commodity 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 Condensed 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 Energy Recovery Mechanism (ERM) in Washington, the Power Cost Adjustment (PCA) mechanism in Idaho, and periodic general rates cases. Regulatory assets are assessed regularly and are probable for recovery through future rates.

**AVISTA CORPORATION**

---

Substantially all forward contracts to purchase or sell power and natural gas are recorded as derivative assets or liabilities at estimated fair value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives are accounted for on the accrual basis 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.

***Fair Value Measurements***

Fair value represents the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Energy commodity derivative assets and liabilities, investments and funds held for clients, deferred compensation assets, as well as derivatives related to interest rate swap agreements and foreign currency exchange contracts, are reported at estimated fair value on the Condensed Consolidated Balance Sheets. See Note 9 for the Company's fair value disclosures.

***Regulatory Deferred Charges and Credits***

The Company prepares its condensed consolidated financial statements in accordance with regulatory accounting practices because:

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

Regulatory accounting practices require that certain costs and/or obligations (such as incurred power and natural gas costs not currently included in rates, but expected to be recovered or refunded in the future) are reflected as deferred charges or credits on the Condensed Consolidated Balance Sheets. These costs and/or obligations are not reflected in the Condensed Consolidated Statements 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 regulatory accounting practices for all or a portion of its regulated operations, the Company could be:

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

***Contingencies***

The Company has unresolved regulatory, legal and tax issues which have inherently uncertain outcomes. The Company accrues a loss contingency if it is probable that a liability has been incurred and the amount of the loss or impairment can be reasonably estimated. The Company also discloses losses that do not meet these conditions for accrual, if there is a reasonable possibility that a loss may be incurred.

**NOTE 2. NEW ACCOUNTING STANDARDS**

Effective January 1, 2012, the Company adopted Accounting Standards Update (ASU) No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." This ASU requires enhanced disclosures for fair value measurements, including quantitative analysis of unobservable inputs used in Level 3 fair value measurements. The ASU also clarifies the FASB's intent about the application of existing fair value measurement requirements. The adoption of this ASU did not have any impact on the Company's financial condition, results of operations and cash flows. See Note 9 for the Company's fair value disclosures.

In September 2011, the Financial Accounting Standards Board (FASB) issued ASU No. 2011-08, "Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment." This ASU amends the guidance on testing goodwill for impairment, providing entities with the option of performing a qualitative assessment before calculating the fair value of the reporting unit. If it is determined, on the basis of the qualitative assessment, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. This ASU does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment. This ASU is effective for goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect that this ASU will have any material impact on its testing of goodwill for impairment.

**NOTE 3. VARIABLE INTEREST ENTITIES**

The Company has a power purchase agreement (PPA) for the purchase of all the output of the Lancaster Plant, a 270 MW natural gas-fired combined cycle combustion turbine plant located in Idaho, owned by an unrelated third-party (Rathdrum Power LLC), through 2026.

**AVISTA CORPORATION**

Avista Corp. has a variable interest in the PPA. Accordingly, Avista Corp. made an evaluation of which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and which interest holders have the obligation to absorb losses or receive benefits that could be significant to the entity. Avista Corp. pays a fixed capacity and operations and maintenance payment and certain monthly variable costs under the PPA. Under the terms of the PPA, Avista Corp. makes the dispatch decisions, provides all natural gas fuel and receives all of the electric energy output from the Lancaster Plant. However, Rathdrum Power LLC (the owner) controls the daily operation of the Lancaster Plant and makes operating and maintenance decisions. Rathdrum Power LLC controls all of the rights and obligations of the Lancaster Plant after the expiration of the PPA in 2026. It is estimated that the plant will have 15 to 25 years of useful life after that time. Rathdrum Power LLC bears the maintenance risk of the plant and will receive the residual value of the Lancaster Plant. Avista Corp. has no debt or equity investments in the Lancaster Plant and does not provide financial support through liquidity arrangements or other commitments (other than the PPA). Based on its analysis, Avista Corp. does not consider itself to be the primary beneficiary of the Lancaster Plant. Accordingly, neither the Lancaster Plant nor Rathdrum Power LLC is included in Avista Corp.'s condensed consolidated financial statements. The Company has a future contractual obligation of approximately \$331 million under the PPA (representing the fixed capacity and operations and maintenance payments through 2026) and believes this would be its maximum exposure to loss. However, the Company believes that such costs will be recovered through retail rates.

Ecova formed a partnership, SEEL, LLC (SEEL) with a third party for the purpose of entering into utility contracts to provide energy efficiency services. SEEL is funded 49 percent by Ecova and 51 percent by the third party. Prior to 2012, Ecova determined that it was the primary beneficiary of SEEL based on its management of the entity and its technical expertise in obtaining and fulfilling the utility contracts, and Ecova was obligated to absorb the losses or receive the benefits that could be significant to SEEL. In 2012, Ecova is no longer the primary beneficiary of SEEL because it is no longer the sole provider of the technical expertise necessary to obtain and fulfill utility contracts. As of January 1, 2012, Ecova uses the equity method to account for its arrangement with SEEL.

**NOTE 4. REDEEMABLE NONCONTROLLING INTERESTS AND SUBSIDIARY ACQUISITIONS**

The acquisition of Cadence Network in July 2008 was funded with the issuance of Ecova common stock. Under the transaction agreement, the previous owners of Cadence Network had a right to have their shares of Ecova common stock redeemed during July 2011 or July 2012 if their investment in Ecova was not liquidated through either an initial public offering or sale of the business to a third party. These redemption rights were not exercised and expired effective July 31, 2012. As such, this redeemable noncontrolling interest was reclassified to equity effective July 31, 2012. Additionally, certain minority shareholders and option holders of Ecova have the right to put their shares back to Ecova at their discretion during an annual put window. The following details redeemable noncontrolling interests as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012	December 31, 2011
Previous owners of Cadence Network	\$41,595	\$ 38,893
Stock options and other outstanding redeemable stock	11,829	12,916
<b>Total redeemable noncontrolling interests</b>	<b>\$53,424</b>	<b>\$ 51,809</b>

On November 30, 2011, Ecova acquired Prenova, Inc. (Prenova), an Atlanta-based energy management company. The cash paid for the acquisition of Prenova of \$35.6 million was funded primarily through borrowings under Ecova's committed credit agreement. The acquired assets and assumed liabilities of Prenova were recorded at their respective estimated fair values as of the date of acquisition. Final purchase accounting is pending the completion of further review of the fair market values of relevant assets and liabilities identified as of the acquisition date. The results of operations of Prenova are included in the condensed consolidated financial statements beginning December 1, 2011.

On January 31, 2012, Ecova acquired LPB Energy Management (LPB), a Dallas, Texas-based energy management company. The cash paid for the acquisition of LPB of \$50.6 million was funded by Ecova through \$25.0 million of borrowings under its committed credit agreement, a \$20.0 million equity infusion from existing shareholders (including Avista Capital and certain other owners of Ecova), and available cash. The acquired assets and assumed liabilities of LPB were recorded at their respective estimated fair values as of the date of acquisition. Assets recorded include the following: accounts receivable of \$2.5 million, goodwill of \$33.5 million, client backlog of \$8.2 million (estimated amortization period of 3 years), client relationships of \$4.8 million (estimated amortization period of 10 years) and internal use software of \$2.5 million (estimated amortization period of 3 to 4 years). These intangible assets are included in other intangibles, property and investments on the Condensed Consolidated Balance

**AVISTA CORPORATION**

---

Sheet. Final purchase accounting is pending the completion of further review of the fair market values of relevant assets and liabilities identified as of the acquisition date. The results of operations of LPB are included in the condensed consolidated financial statements beginning February 1, 2012. The sellers of LPB have the potential to receive additional purchase price payments of \$0.5 million in 2012, \$1.0 million in 2013 and \$1.5 million in 2014. These payments are contingent upon reaching certain revenue thresholds for certain customer contracts. Ecova has recorded a contingent liability of \$0.4 million based on management's assessment of the probability of the revenue thresholds being achieved.

Pro forma disclosures reflecting the effects of Ecova's acquisitions are not presented, as the acquisitions are not material to Avista Corp.'s condensed consolidated results of operations.

**NOTE 5. DERIVATIVES AND RISK MANAGEMENT**

***Energy Commodity Derivatives***

Avista Utilities is exposed to market risks relating to changes in electricity and natural gas commodity prices and certain other fuel prices. Market risk is, in general, the risk of fluctuation in the market price of the commodity being traded and is influenced primarily by supply and demand. Market risk includes the fluctuation in the market price of associated derivative commodity instruments. Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options in order to manage the various risks relating to these commodity price exposures. The Company has an energy resources risk policy and control procedures to manage these risks. The Company's Risk Management Committee establishes the Company's energy resources risk policy and monitors compliance. The Risk Management Committee is comprised of certain Company officers and other members of management. The Audit Committee of the Company's Board of Directors periodically reviews and discusses enterprise risk management processes, and it focuses on the Company's material financial and accounting risk exposures and the steps management has undertaken to control them.

As part of its resource procurement and management operations in the electric business, Avista Utilities engages in an ongoing process of resource optimization, which involves the economic selection from available energy resources to serve Avista Utilities' load obligations and the use of these resources to capture available economic value. Avista Utilities sells and purchases wholesale electric capacity and energy and fuel as part of the process of acquiring and balancing resources to serve its load obligations. These transactions range from terms of 30 minutes up to multiple years.

Avista Utilities makes continuing projections of:

- electric loads at various points in time (ranging from 30 minutes to multiple years) based on, among other things, estimates of customer usage and weather, historical data and contract terms, and
- resource availability at these points in time based on, among other things, fuel choices and fuel markets, estimates of streamflows, availability of generating units, historic and forward market information, contract terms, and experience.

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

- purchasing fuel for generation,
- when economical, selling fuel and substituting wholesale electric purchases, and
- other wholesale transactions to capture the value of generation and transmission resources and fuel delivery capacity contracts.

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

As part of its resource procurement and management of its natural gas business, Avista Utilities makes continuing projections of its natural gas loads and assesses available natural gas resources including natural gas storage availability. Natural gas resource planning typically includes peak requirements, low and average monthly requirements and delivery constraints from natural gas supply locations to Avista Utilities' distribution system. However, daily variations in natural gas demand can be significantly different than monthly demand projections. On the basis of these projections, Avista Utilities plans and executes a series of transactions to hedge a significant portion of its projected natural gas requirements through forward market transactions and derivative instruments. These transactions may extend as much as four natural gas operating years (November through October) into the future. Avista Utilities also leaves a significant portion of its natural gas supply requirements unhedged for purchase in short-term and spot markets.

**AVISTA CORPORATION**

Natural gas resource optimization activities include:

- wholesale market sales of surplus natural gas supplies,
- optimization of interstate pipeline transportation capacity not needed to serve daily load, and
- purchases and sales of natural gas to optimize use of storage capacity.

The following table presents the underlying energy commodity derivative volumes as of June 30, 2012 that are expected to settle in each respective year (in thousands of MWhs and mmBTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical MWH	Financial MWH	Physical mmBTUs	Financial mmBTUs	Physical MWH	Financial MWH	Physical mmBTUs	Financial mmBTUs
2012	1,370	1,772	18,759	56,414	431	1,184	6,862	61,340
2013	568	2,028	13,198	72,086	310	2,265	1,533	58,368
2014	366	128	6,316	37,139	286	1,275	1,786	15,207
2015	379	—	3,390	11,917	286	608	—	913
2016	367	—	1,365	455	287	—	—	—
Thereafter	949	—	—	—	730	—	—	—

**Foreign Currency Exchange Contracts**

A significant portion of Avista Utilities' natural gas supply (including fuel for power generation) is obtained from Canadian sources. Most of those transactions are executed in U.S. dollars, which avoids foreign currency risk. A portion of Avista Utilities' short-term natural gas transactions and long-term Canadian transportation contracts are committed based on Canadian currency prices and settled within sixty days with U.S. dollars. Avista Utilities economically hedges a portion of the foreign currency risk by purchasing Canadian currency contracts when such commodity transactions are initiated. This risk has not had a material effect on the Company's financial condition, results of operations or cash flows and these differences in cost related to currency fluctuations were included with natural gas supply costs for ratemaking. The following table summarizes the foreign currency hedges that the Company has entered into as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012	December 31, 2011
Number of contracts	29	28
Notional amount (in United States dollars)	\$9,423	\$ 7,033
Notional amount (in Canadian dollars)	9,643	7,192

**Interest Rate Swap Agreements**

Avista Corp. hedges a portion of its interest rate risk with financial derivative instruments, which may include interest rate swaps and U.S. Treasury lock agreements. These interest rate swap agreements are considered economic hedges against fluctuations in future cash flows associated with anticipated debt issuances. The following table summarizes the interest rate swaps that the Company has entered into as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012	December 31, 2011
Number of contracts	—	3
Notional amount	—	\$ 75,000
Mandatory cash settlement date	—	July 2012
Number of contracts	2	2
Notional amount	\$ 85,000	\$ 85,000
Mandatory cash settlement date	June 2013	June 2013
Number of contracts	2	—
Notional amount	\$ 50,000	—
Mandatory cash settlement date	October 2014	—
Number of contracts	1	—
Notional amount	\$ 25,000	—
Mandatory cash settlement date	October 2015	—

In May 2012, the Company cash settled interest rate swap contracts (notional amount of \$75.0 million) and paid a total of \$18.5 million. The interest rate swap contracts were settled in connection with the pricing of \$80.0 million of First Mortgage Bonds (see Note 8). Upon settlement of the interest rate swaps, the regulatory asset or liability (included as part of long-term debt) is amortized as a component of interest expense over the life of the forecasted interest payments.

**AVISTA CORPORATION**
**Derivative Instruments Summary**

The following table presents the fair values and locations of derivative instruments recorded on the Condensed Consolidated Balance Sheet as of June 30, 2012 (in thousands):

Derivative	Balance Sheet Location	Fair Value			Net Asset (Liability)
		Asset	Liability	Collateral Netting	
Foreign currency contracts	Other current assets	\$ 41	\$ —	\$ —	\$ 41
Interest rate contracts	Other current liabilities	—	(5,244)	—	(5,244)
Interest rate contracts	Other intangibles, property and Investments - net	3,412	—	—	3,412
Commodity contracts	Current utility energy commodity derivative assets	1,782	(437)	—	1,345
Commodity contracts	Non-current utility energy commodity derivative assets	487	(23)	—	464
Commodity contracts	Current utility energy commodity derivative liabilities	57,622	(120,442)	7,793	(55,027)
Commodity contracts	Other non-current liabilities and deferred credits	31,414	(65,796)	7,228	(27,154)
Total derivative instruments recorded on the balance sheet		<u>\$94,758</u>	<u>\$(191,942)</u>	<u>\$15,021</u>	<u>\$(82,163)</u>

The following table presents the fair values and locations of derivative instruments recorded on the Condensed Consolidated Balance Sheet as of December 31, 2011 (in thousands):

Derivative	Balance Sheet Location	Fair Value		Net Asset (Liability)
		Asset	Liability	
Foreign currency contracts	Other current assets	\$ 32	\$ —	\$ 32
Interest rate contracts	Other current liabilities	—	(16,253)	(16,253)
Interest rate contracts	Other non-current liabilities and deferred credits	—	(2,642)	(2,642)
Commodity contracts	Current utility energy commodity derivative assets	1,618	(479)	1,139
Commodity contracts	Non-current utility energy commodity derivative assets	185	—	185
Commodity contracts	Current utility energy commodity derivative liabilities	40,090	(110,914)	(70,824)
Commodity contracts	Other non-current liabilities and deferred credits	44,308	(84,838)	(40,530)
Total derivative instruments recorded on the balance sheet		<u>\$86,233</u>	<u>\$(215,126)</u>	<u>\$(128,893)</u>

**Exposure to Demands for Collateral**

The Company's derivative contracts often require collateral (in the form of cash or letters of credit) or other credit enhancements, or reductions or terminations of a portion of the contract through cash settlement, in the event of a downgrade in the Company's credit ratings or changes in market prices. In periods of price volatility, the level of exposure can change significantly. As a result, sudden and significant demands may be made against the Company's credit facilities and cash. The Company actively monitors the exposure to possible collateral calls and takes steps to mitigate capital requirements. As of June 30, 2012, the Company had cash deposited as collateral of \$19.0 million and letters of credit of \$17.5 million outstanding related to its energy derivative contracts. The Consolidated Balance Sheet at June 30, 2012 reflects the offsetting of \$15.0 million of cash collateral against net derivative positions where a legal right of offset exists.

Certain of the Company's derivative instruments contain provisions that require the Company to maintain an investment grade credit rating from the major credit rating agencies. If the Company's credit ratings were to fall below "investment grade," it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position as of June 30, 2012 was \$155.0 million. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2012, the Company could be required to post \$51.5 million of additional collateral to its counterparties.

**Credit Risk**

Credit risk relates to the potential losses that the Company would incur as a result of non-performance by counterparties of their contractual obligations to deliver energy or make financial settlements. The Company often extends credit to counterparties and customers and is exposed to the risk that it may not be able to collect amounts owed to the Company. Credit risk includes potential counterparty default due to circumstances:

- relating directly to it,
- caused by market price changes, and
- relating to other market participants that have a direct or indirect relationship with such counterparty.

Changes in market prices may dramatically alter the size of credit risk with counterparties, even when conservative credit limits are established. Should a counterparty fail to perform, the Company may be required to honor the underlying commitment or to replace existing contracts with contracts at then-current market prices. The Company seeks to mitigate credit risk by:

- entering into bilateral contracts that specify credit terms and protections against default,
- applying credit limits and duration criteria to existing and prospective counterparties,
- actively monitoring current credit exposures, and
- conducting transactions on exchanges with fully collateralized clearing arrangements that significantly reduce counterparty default risk.

The Company's credit policy includes an evaluation of the financial condition of counterparties. Credit risk management includes collateral requirements or other credit enhancements, such as letters of credit or parent company guarantees. The Company enters into various agreements that address credit risks including standardized agreements that allow for the netting or offsetting of positive and negative exposures.

The Company has concentrations of suppliers and customers in the electric and natural gas industries including:

- electric and natural gas utilities,
- electric generators and transmission providers,
- natural gas producers and pipelines,
- financial institutions including commodity clearing exchanges and related parties, and
- energy marketing and trading companies.

In addition, the Company has concentrations of credit risk related to geographic location as it operates in the western United States and western Canada. These concentrations of counterparties and concentrations of geographic location may impact the Company's overall exposure to credit risk because the counterparties may be similarly affected by changes in conditions.

The Company maintains credit support agreements with certain counterparties and margin calls are periodically made and/or received. Margin calls are triggered when exposures exceed contractual limits or when there are changes in a counterparty's creditworthiness. Price movements in electricity and natural gas can generate exposure levels in excess of these contractual limits. Negotiating for collateral in the form of cash, letters of credit, or performance guarantees is common industry practice.

**NOTE 6. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS**

The Company has a defined benefit pension plan covering substantially all regular full-time employees at Avista Utilities. Individual benefits under this plan are based upon the employee's years of service, date of hire 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 contributed \$26 million in cash to the pension plan in 2011. The Company expects to contribute \$44 million in cash to the pension plan in 2012 (\$29.4 million was contributed during the six months ended June 30, 2012).

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

**AVISTA CORPORATION**

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

The Company provides death benefits to beneficiaries of executive officers who die during their term of office or after retirement. Under the plan, an executive officer's designated beneficiary will receive a payment equal to twice the executive officer's annual base salary at the time of death (or if death occurs after retirement, a payment equal to twice the executive officer's total annual pension benefit). The liability and expense for this plan are included as other postretirement benefits.

The Company uses a December 31 measurement date for its pension and other postretirement benefit 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		Other Post-retirement Benefits	
	2012	2011	2012	2011
<b>Three months ended June 30:</b>				
Service cost	\$ 3,891	\$ 3,303	\$ 689	\$ 639
Interest cost	6,084	6,017	1,256	1,091
Expected return on plan assets	(5,950)	(5,775)	(375)	(357)
Transition obligation recognition	—	—	125	124
Amortization of prior service cost	75	125	(37)	(37)
Net loss recognition	3,021	2,298	1,252	1,239
Net periodic benefit cost	<u>\$ 7,121</u>	<u>\$ 5,968</u>	<u>\$2,910</u>	<u>\$2,699</u>
<b>Six months ended June 30:</b>				
Service cost	\$ 7,682	\$ 6,245	\$1,378	\$ 866
Interest cost	12,193	12,126	2,537	2,010
Expected return on plan assets	(11,950)	(11,366)	(750)	(800)
Transition obligation recognition	—	—	250	250
Amortization of prior service cost	150	244	(74)	(74)
Net loss recognition	5,778	4,403	2,564	1,674
Net periodic benefit cost	<u>\$ 13,853</u>	<u>\$ 11,652</u>	<u>\$5,905</u>	<u>\$3,926</u>

**NOTE 7. SHORT-TERM BORROWINGS**

**Avista Corp.**

Avista Corp. has a committed line of credit with various financial institutions in the total amount of \$400.0 million with an expiration date of February 2017. The committed line of credit is secured by non-transferable First Mortgage Bonds of the Company issued to the agent bank that would only become due and payable in the event, and then only to the extent, that the Company defaults on its obligations under the committed line of credit.

The committed line of credit agreement contains customary covenants and default provisions. The credit agreement has a covenant which does not permit the ratio of "consolidated total debt" to "consolidated total capitalization" of Avista Corp. to be greater than 65 percent at any time. As of June 30, 2012, the Company was in compliance with this covenant.

Balances outstanding and interest rates of borrowings (excluding letters of credit) under the Company's revolving committed lines of credit were as follows as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012	December 31, 2011
Balance outstanding at end of period	\$91,000	\$ 61,000
Letters of credit outstanding at end of period	\$25,075	\$ 29,030
Average interest rate at end of period	1.20%	1.12%

**AVISTA CORPORATION**

**Ecova**

As of June 30, 2012, Ecova had a \$60.0 million committed line of credit agreement with a financial institution that was scheduled to expire in April 2014. In July 2012, Ecova entered into a new five-year \$125.0 million committed line of credit agreement with various financial institutions that replaced its \$60.0 million committed line of credit agreement. The credit agreement is secured by substantially all of Ecova's assets. Balances outstanding and interest rates of borrowings under Ecova's credit agreements were as follows as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012	December 31, 2011
Balance outstanding at end of period	\$60,000	\$ 35,000
Average interest rate at end of period	2.25%	2.38%

As of June 30, 2012, borrowings under Ecova's committed line of credit were classified as long-term.

**NOTE 8. LONG-TERM DEBT**

The following details long-term debt outstanding as of June 30, 2012 and December 31, 2011 (dollars in thousands):

Maturity Year	Description	Interest Rate	June 30, 2012	December 31, 2011
2012	Secured Medium-Term Notes	7.37%	\$ —	\$ 7,000
2013	First Mortgage Bonds	1.68%	50,000	50,000
2018	First Mortgage Bonds	5.95%	250,000	250,000
2018	Secured Medium-Term Notes	7.39%-7.45%	22,500	22,500
2019	First Mortgage Bonds	5.45%	90,000	90,000
2020	First Mortgage Bonds	3.89%	52,000	52,000
2022	First Mortgage Bonds	5.13%	250,000	250,000
2023	Secured Medium-Term Notes	7.18%-7.54%	13,500	13,500
2028	Secured Medium-Term Notes	6.37%	25,000	25,000
2032	Secured Pollution Control Bonds (1)	(1)	66,700	66,700
2034	Secured Pollution Control Bonds (2)	(2)	17,000	17,000
2035	First Mortgage Bonds	6.25%	150,000	150,000
2037	First Mortgage Bonds	5.70%	150,000	150,000
2040	First Mortgage Bonds	5.55%	35,000	35,000
2041	First Mortgage Bonds	4.45%	85,000	85,000
	Total secured long-term debt		1,256,700	1,263,700
2023	Unsecured Pollution Control Bonds	6.00%	—	4,100
	Other long-term debt and capital leases		5,290	5,455
	Settled interest rate swaps		(28,560)	(10,629)
	Unamortized debt discount		(1,542)	(1,626)
	Total		1,231,888	1,261,000
	Secured Pollution Control Bonds held by Avista Corporation (1) (2)		(83,700)	(83,700)
	Current portion of long-term debt		(423)	(7,474)
	Total long-term debt		<u>\$1,147,765</u>	<u>\$1,169,826</u>

- In December 2010, \$66.7 million of the City of Forsyth, Montana Pollution Control Revenue Refunding Bonds (Avista Corporation Colstrip Project) due 2032, which had been held by Avista Corp. since 2008, were refunded by a new bond issue (Series 2010A). The new bonds were not offered to the public and were purchased by Avista Corp. due to market conditions. The Company expects that at a later date, subject to market conditions, these bonds may be remarketed to unaffiliated investors. So long as Avista Corp. is the holder of these bonds, the bonds will not be reflected as an asset or a liability on Avista Corp.'s Condensed Consolidated Balance Sheet.
- In December 2010, \$17.0 million of the City of Forsyth, Montana Pollution Control Revenue Refunding Bonds, (Avista Corporation Colstrip Project) due 2034, which had been held by Avista Corp. since 2009, were refunded by a new bond issue (Series 2010B). The new bonds were not offered to the public and were purchased by Avista Corp. due to market conditions. The Company expects that at a later date, subject to market conditions, the bonds may be remarketed to unaffiliated investors. So long as Avista Corp. is the holder of these bonds, the bonds will not be reflected as an asset or a liability on Avista Corp.'s Condensed Consolidated Balance Sheet.

**AVISTA CORPORATION**

In June 2012, Avista Corp. entered into a bond purchase agreement with certain institutional investors in the private placement market for the purpose of issuing \$80.0 million of 4.23 percent First Mortgage Bonds due in 2047. The new First Mortgage Bonds will be issued under and in accordance with the Mortgage and Deed of Trust, dated as of June 1, 1939, from the Company to Citibank, N.A., trustee, as amended and supplemented by various supplemental indentures and other instruments. The issuance of the bonds will occur at closing in November 2012. The total net proceeds from the sale of the new bonds will be used to repay a portion of the borrowings outstanding under the Company's \$400.0 million committed line of credit and for general corporate purposes.

**Nonrecourse Long-Term Debt**

Nonrecourse long-term debt (including current portion) represents the long-term debt of Spokane Energy. To provide funding to acquire a long-term fixed rate electric capacity contract from Avista Corp., Spokane Energy borrowed \$145.0 million from a funding trust in December 1998. The long-term debt has scheduled monthly installments and interest at a fixed rate of 8.45 percent with the final payment due in January 2015. Spokane Energy bears full recourse risk for the debt, which is secured by the fixed rate electric capacity contract and \$1.6 million of funds held in a trust account.

**NOTE 9. FAIR VALUE**

The carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable and short-term borrowings are reasonable estimates of their fair values. Long-term debt (including current portion, but excluding capital leases), nonrecourse long-term debt and long-term debt to affiliated trusts are reported at carrying value on the Condensed Consolidated Balance Sheets.

The fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy are defined as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 – Pricing inputs include significant inputs that are generally unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values incorporates various factors that not only include the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits and letters of credit), but also the impact of Avista Corp.'s nonperformance risk on its liabilities.

The following table sets forth the carrying value and estimated fair value of the Company's financial instruments not reported at estimated fair value on the Condensed Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term debt (Level 2)	\$951,000	\$1,129,841	\$962,100	\$1,135,536
Long-term debt (Level 3)	222,000	244,061	222,000	234,226
Nonrecourse long-term debt (Level 3)	39,778	43,205	46,471	51,974
Long-term debt to affiliated trusts (Level 3)	51,547	43,743	51,547	43,810

**AVISTA CORPORATION**

These estimates of fair value of long-term debt and long-term debt to affiliated trusts were primarily based on available market information. The Company's publicly held long-term debt was classified as Level 2, as the fair value was determined utilizing observable inputs in non-active markets. The Company's other long-term debt (including long-term debt to affiliated trusts and nonrecourse long-term debt) was classified as Level 3, as certain inputs used to determine the fair value are unobservable. In particular, due to the unique nature of the long-term fixed rate electric capacity contract securing the long-term debt of Spokane Energy (nonrecourse long-term debt), the estimated fair value of nonrecourse long-term debt was determined based on a discounted cash flow model using available market information.

The following table discloses by level within the fair value hierarchy the Company's assets and liabilities measured and reported on the Condensed Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011 at fair value on a recurring basis (dollars in thousands):

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>June 30, 2012</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 88,753	\$ —	\$ (86,944)	\$ 1,809
Level 3 energy commodity derivatives:					
Power exchange agreements	—	—	2,552	(2,552)	—
Interest rate swaps	—	3,412	—	—	3,412
Foreign currency derivatives	—	41	—	—	41
Investments and funds held for clients:					
Cash and cash equivalents	38,933	—	—	—	38,933
Securities available for sale:					
U.S. government agency	—	66,450	—	—	66,450
Municipal	—	8,726	—	—	8,726
Corporate fixed income – financial	—	6,625	—	—	6,625
Corporate fixed income – industrial	—	4,979	—	—	4,979
Corporate fixed income – utility	—	2,126	—	—	2,126
Certificate of deposits	—	1,240	—	—	1,240
Funds held in trust account of Spokane Energy	1,600	—	—	—	1,600
Deferred compensation assets:					
Fixed income securities (2)	2,184	—	—	—	2,184
Equity securities (2)	5,577	—	—	—	5,577
<b>Total</b>	<b>\$48,294</b>	<b>\$182,352</b>	<b>\$ 2,552</b>	<b>\$ (89,496)</b>	<b>\$143,702</b>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$169,226	\$ —	\$ (101,966)	\$ 67,260
Level 3 energy commodity derivatives:					
Natural gas exchange agreements	—	—	2,727	—	2,727
Power exchange agreements	—	—	12,990	(2,552)	10,438
Power option agreements	—	—	1,756	—	1,756
Interest rate swaps	—	5,244	—	—	5,244
<b>Total</b>	<b>\$ —</b>	<b>\$174,470</b>	<b>\$17,473</b>	<b>\$ (104,518)</b>	<b>\$ 87,425</b>

**AVISTA CORPORATION**

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>December 31, 2011</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 80,571	\$ —	\$ (79,247)	\$ 1,324
Level 3 energy commodity derivatives:					
Natural gas exchange agreements	—	—	956	(956)	—
Power exchange agreements	—	—	4,674	(4,674)	—
Foreign currency derivatives	—	32	—	—	32
Investments and funds held for clients:					
Cash and cash equivalents	21,957	—	—	—	21,957
Securities available for sale:					
U.S. government agency	—	74,893	—	—	74,893
Municipal	—	425	—	—	425
Corporate fixed income – financial	—	11,154	—	—	11,154
Corporate fixed income – industrial	—	6,518	—	—	6,518
Corporate fixed income – utility	—	2,092	—	—	2,092
Certificate of deposits	—	1,497	—	—	1,497
Funds held in trust account of Spokane Energy	1,600	—	—	—	1,600
Deferred compensation assets:					
Fixed income securities (2)	2,116	—	—	—	2,116
Equity securities (2)	5,252	—	—	—	5,252
<b>Total</b>	<b><u>\$30,925</u></b>	<b><u>\$177,182</u></b>	<b><u>\$ 5,630</u></b>	<b><u>\$ (84,877)</u></b>	<b><u>\$128,860</u></b>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$177,743	\$ —	\$ (79,247)	\$ 98,496
Level 3 energy commodity derivatives:					
Natural gas exchange agreements	—	—	2,644	(956)	1,688
Power exchange agreements	—	—	14,584	(4,674)	9,910
Power option agreements	—	—	1,260	—	1,260
Interest rate swaps	—	18,895	—	—	18,895
<b>Total</b>	<b><u>\$ —</u></b>	<b><u>\$196,638</u></b>	<b><u>\$18,488</u></b>	<b><u>\$ (84,877)</u></b>	<b><u>\$130,249</u></b>

- (1) The Company is permitted to net derivative assets and derivative liabilities with the same counterparty when a legally enforceable master netting agreement exists. In addition, the Company nets derivative assets and derivative liabilities against any payables and receivables for cash collateral held or placed with these same counterparties.
- (2) These assets are trading securities and are included in other intangibles, property and investments-net on the Condensed Consolidated Balance Sheets.

Avista Utilities enters into forward contracts to purchase or sell a specified amount of energy at a specified time, or during a specified period, in the future. These contracts are entered into as part of Avista Utilities' management of loads and resources and certain contracts are considered derivative instruments. The difference between the amount of derivative assets and liabilities disclosed in respective levels and the amount of derivative assets and liabilities disclosed on the Condensed Consolidated Balance Sheets is due to netting arrangements with certain counterparties. The Company uses quoted market prices and forward price curves to estimate the fair value of utility derivative commodity instruments included in Level 2. In particular, electric derivative valuations are performed using broker quotes, adjusted for periods in between quotable periods. Natural gas derivative valuations are estimated using New York Mercantile Exchange (NYMEX) pricing for similar instruments, adjusted for basin differences, using broker quotes. Where observable inputs are available for substantially the full term of the contract, the derivative asset or liability is included in Level 2.

For securities available for sale (held at Ecova) the Company uses a nationally recognized third party to obtain fair value and reviews these prices for accuracy using a variety of market tools and analysis. The Company's pricing vendor uses a generic model which uses standard inputs (listed in order of priority for use), including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, market bids/offers and other reference data. The pricing vendor also monitors market indicators, as well as industry and economic events. Further, the model uses Option Adjusted Spread and is a multidimensional relational model. All securities available for sale were deemed Level 2.

**AVISTA CORPORATION**

Deferred compensation assets and liabilities represent funds held by the Company in a Rabbi Trust for an executive deferral plan. These funds consist of actively traded equity and bond funds with quoted prices in active markets. The balance disclosed in the table above excludes cash and cash equivalents of \$1.0 million as of June 30, 2012 and \$1.3 million as of December 31, 2011.

**Level 3 Fair Value**

For power exchange agreements, the Company compares the Level 2 brokered quotes and forward price curves described above to an internally developed forward price which is based on the average operating and maintenance (O&M) charges from four surrogate nuclear power plants around the country for the current year. Because the nuclear power plant O&M charges are only known for one year, all forward years are estimated assuming an annual escalation. In addition to the forward price being estimated using unobservable inputs, the Company also estimates the volumes of the transactions that will take place in the future based on historical average transaction volumes per delivery year (November to April). Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the current year O&M charges for the surrogate plants is accompanied by a directionally similar change in O&M charges in future years. There is generally not a correlation between external market prices and the O&M charges used to develop the internal forward price.

For power commodity option agreements, the Company uses the Black-Scholes-Merton valuation model to estimate the fair value, and this model includes significant inputs not observable or corroborated in the market. These inputs include 1) the strike price (which is an internally derived price based on a combination of generation plant heat rate factors, natural gas market pricing, delivery and other O&M charges, 2) estimated delivery volumes for years beyond 2012, and 3) volatility rates for periods beyond July 2015. Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, changes in overall commodity market prices and volatility rates are accompanied by directionally similar changes in the strike price and volatility assumptions used in the calculation.

For natural gas commodity exchange agreements, the Company uses the same Level 2 brokered quotes described above; however, the Company also estimates the purchase and sales volumes (within contractual limits) as well as the timing of those transactions. Changing the timing of volume estimates changes the timing of purchases and sales, impacting which brokered quote is used. Because the brokered quotes can vary significantly from period to period, the unobservable estimates of the timing and volume of transactions can have a significant impact on the calculated fair value. The Company currently estimates volumes and timing of transactions based on a most likely scenario using historical data. Historically, the timing and volume of transactions have not been highly correlated with market prices and market volatility.

The following table presents the quantitative information which was used to estimate the fair values of the Level 3 assets and liabilities above as of June 30, 2012 (dollars in thousands):

	Fair Value (Net) at June 30, 2012	Valuation Technique	Unobservable Input	Range
Power exchange agreements	\$ (10,438)	Surrogate facility pricing	O&M charges Escalation factor Transaction volumes	\$29.01 - \$43.81/MWh (1) 5% - 2012 to 2015 3% - 2016 to 2019 365,619 - 379,156 MWhs
Power option agreements	(1,756)	Black-Scholes-Merton	Strike price Delivery volumes Volatility rates	\$41.22/MWh - 2012 \$73.22/MWh - 2019 157,517 - 287,147 MWhs 0.20 (2)
Natural gas exchange agreements	(2,727)	Internally derived weighted average cost of gas	Forward purchase prices Forward sales prices Purchase volumes Sales volumes	\$2.42 - \$3.35/mmBTU \$3.43 - \$4.37/mmBTU 135,000 - 465,000 mmBTUs 140,010 - 310,000 mmBTUs

(1) The average O&M charges for 2012 were \$36.73 per MWh.

(2) The estimated volatility rate of 0.20 is compared to actual known volatility rates of 0.51 for 2012 to 0.24 in July 2015.

**AVISTA CORPORATION**

Avista Corp.'s risk management team and accounting team are responsible for developing the valuation methods described above and both groups report to the Chief Financial Officer. The valuation methods, the significant inputs, and the resulting fair values described above are reviewed on at least a quarterly basis by the risk management team and the accounting team to ensure they provide a reasonable estimate of fair value each reporting period.

The following table presents activity for net energy commodity derivative assets (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2012 and 2011 (dollars in thousands):

	Natural Gas Exchange Agreements	Power Exchange Agreements	Power Option Agreements	Total
<b>Three months ended June 30, 2012:</b>				
Balance as of April 1, 2012	\$ (2,354)	\$ (18,572)	\$ (987)	\$ (21,913)
Total gains or losses (realized/unrealized):				
Included in net income	—	—	—	—
Included in other comprehensive income	—	—	—	—
Included in regulatory assets/liabilities (1)	(162)	6,909	(769)	5,978
Purchases	—	—	—	—
Issuances	—	—	—	—
Settlements	(211)	1,225	—	1,014
Transfers to other categories	—	—	—	—
Ending balance as of June 30, 2012	<u>\$ (2,727)</u>	<u>\$ (10,438)</u>	<u>\$ (1,756)</u>	<u>\$ (14,921)</u>
<b>Six months ended June 30, 2012:</b>				
Balance as of January 1, 2012	\$ (1,688)	\$ (9,910)	\$ (1,260)	\$ (12,858)
Total gains or losses (realized/unrealized):				
Included in net income	—	—	—	—
Included in other comprehensive income	—	—	—	—
Included in regulatory assets/liabilities (1)	13	(4,778)	(496)	(5,261)
Purchases	—	—	—	—
Issuances	—	—	—	—
Settlements	(1,052)	4,250	—	3,198
Transfers to other categories	—	—	—	—
Ending balance as of June 30, 2012	<u>\$ (2,727)</u>	<u>\$ (10,438)</u>	<u>\$ (1,756)</u>	<u>\$ (14,921)</u>
<b>Three months ended June 30, 2011:</b>				
Balance as of April 1, 2011	\$ —	\$ 15,862	\$ (1,533)	\$ 14,329
Total gains or losses (realized/unrealized):				
Included in net income	—	—	—	—
Included in other comprehensive income	—	—	—	—
Included in regulatory assets/liabilities (1)	—	(3,793)	224	(3,569)
Purchases	—	—	—	—
Issuances	—	—	—	—
Settlements	—	989	—	989
Transfers to other categories	(4,404)	—	—	(4,404)
Ending balance as of June 30, 2011	<u>\$ (4,404)</u>	<u>\$ 13,058</u>	<u>\$ (1,309)</u>	<u>\$ 7,345</u>
<b>Six months ended June 30, 2011:</b>				
Balance as of January 1, 2011	\$ —	\$ 15,793	\$ (2,334)	\$ 13,459
Total gains or losses (realized/unrealized):				
Included in net income	—	—	—	—
Included in other comprehensive income	—	—	—	—
Included in regulatory assets/liabilities (1)	—	(4,680)	1,025	(3,655)
Purchases	—	—	—	—
Issuances	—	—	—	—
Settlements	—	1,945	—	1,945
Transfers to other categories	(4,404)	—	—	(4,404)
Ending balance as of June 30, 2011	<u>\$ (4,404)</u>	<u>\$ 13,058</u>	<u>\$ (1,309)</u>	<u>\$ 7,345</u>

- (1) The WUTC and the IPUC issued accounting orders authorizing Avista Utilities to offset commodity derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the

**AVISTA CORPORATION**

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 Condensed 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 in Washington, the PCA mechanism in Idaho, and periodic general rates cases.

**NOTE 10. EARNINGS PER COMMON SHARE ATTRIBUTABLE TO AVISTA CORPORATION**

The following table presents the computation of basic and diluted earnings per common share attributable to Avista Corporation 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,	
	2012	2011	2012	2011
<b>Numerator:</b>				
Net income attributable to Avista Corporation	\$18,178	\$23,001	\$56,566	\$64,919
Subsidiary earnings adjustment for dilutive securities	(47)	(96)	(9)	(170)
Adjusted net income attributable to Avista Corporation for computation of diluted earnings per common share	<u>\$18,131</u>	<u>\$22,905</u>	<u>\$56,557</u>	<u>\$64,749</u>
<b>Denominator:</b>				
Weighted-average number of common shares outstanding-basic	58,702	57,787	58,642	57,565
Effect of dilutive securities:				
Performance and restricted stock awards	211	306	277	159
Stock options	<u>11</u>	<u>50</u>	<u>18</u>	<u>56</u>
Weighted-average number of common shares outstanding-diluted	<u>58,924</u>	<u>58,143</u>	<u>58,937</u>	<u>57,780</u>
Potential shares excluded in calculation	—	—	—	—
<b>Earnings per common share attributable to Avista Corporation:</b>				
Basic	<u>\$ 0.31</u>	<u>\$ 0.40</u>	<u>\$ 0.96</u>	<u>\$ 1.13</u>
Diluted	<u>\$ 0.31</u>	<u>\$ 0.39</u>	<u>\$ 0.96</u>	<u>\$ 1.12</u>

**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. For all such matters, 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. For matters that affect Avista Utilities' operations, the Company intends to seek, to the extent appropriate, recovery of incurred costs through the ratemaking process. With respect to matters discussed in this Note relating to Avista Energy, any potential liabilities or refunds by Avista Energy remain the responsibility of Avista Corp. and/or its subsidiaries and were not assumed by the purchaser of Avista Energy's contracts and operations in 2007.

**Federal Energy Regulatory Commission Inquiry**

In April 2004, the Federal Energy Regulatory Commission (FERC) approved the contested Agreement in Resolution of Section 206 Proceeding (Agreement in Resolution) between Avista Corp. doing business as Avista Utilities, Avista Energy and the FERC's Trial Staff which stated that there was: (1) no evidence that any executives or employees of Avista Utilities or Avista Energy knowingly engaged in or facilitated any improper trading strategy during 2000 and 2001; (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) no finding that Avista Utilities or Avista Energy withheld relevant information from the FERC's inquiry into the western energy markets for 2000 and 2001 (Trading Investigation). The Attorney General of the State of California (California AG), the California Electricity Oversight Board, and the City of Tacoma, Washington challenged the FERC's decisions approving the Agreement in Resolution, which are now pending before the United States Court of Appeals for the Ninth Circuit (Ninth Circuit).

In May 2004, the FERC provided notice that Avista Energy was no longer subject to an investigation reviewing certain bids above \$250 per MW in the short-term energy markets operated by the California Independent System

**AVISTA CORPORATION**

---

Operator (CalISO) and the California Power Exchange (CalPX) from May 1, 2000 to October 2, 2000 (Bidding Investigation). That matter is also pending before the Ninth Circuit, after the California AG, Pacific Gas & Electric (PG&E), Southern California Edison Company (SCE) and the California Public Utilities Commission (CPUC) filed petitions for review in 2005.

Based on the FERC's order approving the Agreement in Resolution in the Trading Investigation and order denying rehearing requests, the Company does not expect that this proceeding will have any material effect on its financial condition, results of operations or cash flows. Furthermore, based on information currently known to the Company regarding the Bidding Investigation and the fact that the FERC Staff did not find any evidence of manipulative behavior, the Company does not expect that this matter will have a material effect on its financial condition, results of operations or cash flows.

***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 (Refund Period). Proposed refunds are based on the calculation of mitigated market clearing prices for each hour. The FERC ruled that if the refunds required by the formula would cause a seller to recover less than its actual costs for the Refund Period, sellers may document these costs and limit their refund liability commensurately. In September 2005, Avista Energy submitted its cost filing claim pursuant to the FERC's August 2005 order. The filing was initially accepted by the FERC, but in March 2011, the FERC ordered Avista Energy to remove any return on equity in a compliance filing with the CalISO, which Avista Energy did in April 2011. A challenge to Avista Energy's cost filing by the California AG, the CPUC, PG&E and SCE was denied in July 2011 as a collateral attack on the FERC's prior orders accepting Avista Energy's cost filing. In July 2011, the California AG, the CPUC, PG&E and SCE filed a petition for review of the FERC's orders regarding Avista Energy's cost filing with the Ninth Circuit.

The 2001 bankruptcy of PG&E resulted in a default on its payment obligations to the CalPX. As a result, Avista Energy has not been paid for all of its energy sales during the Refund Period. Those funds are now in escrow accounts and will not be released until the FERC issues an order directing such release in the California refund proceeding. The CalISO continues to work on its compliance filing for the Refund Period, which will show "who owes what to whom." In July 2011, the FERC accepted the preparatory rerun compliance filings by the CalPX and CalISO, and responded to the CalPX request for guidance on issues related to completing the final determination of "who owes what to whom." The FERC directed both the CalISO and the CalPX to prepare and submit to the FERC their final refund rerun compliance filings. The FERC's order also directs the CalPX to pay past due principal amounts to governmental entities. In February 2012, the FERC denied the challenges made to the July 2011 order by the California AG, the CPUC, PG&E and SCE. As of June 30, 2012, Avista Energy's accounts receivable outstanding related to defaulting parties in California were fully offset by reserves for uncollected amounts and funds collected from the defaulting parties.

Many of the orders that the FERC has issued in the California refund proceedings were appealed to the Ninth Circuit. In October 2004, the Ninth Circuit ordered that briefing proceed in two rounds. The first round was 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 FPA; (2) the temporal scope of refunds under section 206 of the FPA; and (3) which categories of transactions are subject to refunds. The second round of issues and their corresponding briefing schedules have not yet been set by the Ninth Circuit.

In September 2005, the Ninth Circuit held that the FERC did not have the authority to order refunds for sales made by municipal utilities in the California refund proceeding. In August 2006, the Ninth Circuit upheld October 2, 2000 as the refund effective date for the FPA section 206 refund proceeding, but remanded to the FERC its decision not to consider an FPA section 309 remedy for tariff violations prior to that date. In an order issued in May 2011, the FERC clarified the issues set for hearing for the period May 1, 2000 – October 1, 2000 (Summer Period): (1) which market practices and behaviors constitute a violation of the then-current CAISO, CalPX, and individual seller's tariffs and FERC orders; (2) whether any of the sellers named as respondents in this proceeding engaged in those tariff violations; and (3) whether any such tariff violations affected the market clearing price. The FERC reiterated that the California Parties are expected to be very specific when presenting their arguments and evidence, and that general claims would not suffice. The FERC also gave the California Parties an opportunity to show that exchange transactions with the CalISO during the Refund Period were not just and reasonable. Avista Energy has one exchange transaction with the CalISO. The California AG, the CPUC, PG&E and SCE filed for rehearing of the FERC's May 2011 order, arguing that it improperly denies them a market-wide remedy for the pre-refund period. They also filed a petition for review of the May 2011 order with the Ninth Circuit. A FERC hearing commenced on April 11, 2012 and concluded on July 19, 2012. Briefs are due September 28, 2012, and reply briefs are due December 4, 2012.

**AVISTA CORPORATION**

---

The initial decision is to be issued no later than February 15, 2013. On June 19, 2012, the presiding administrative law judge issued an order adopting a stipulation between the California Parties, Avista Utilities and others in the proceeding stating that there are no allegations that Avista Utilities violated the then-current CAISO, CalPX, or individual seller's tariffs or FERC orders during the Summer Period, or that Avista Utilities affected the market clearing price in any hour during the Summer Period. Based on that June 19 order, on July 10, 2012, Avista Utilities filed a motion with the FERC for dismissal of all claims by the California Parties in the remanded proceeding.

Because the resolution of the California refund proceeding remains uncertain, legal counsel cannot express an opinion on the extent of the Company's liability, if any. However, based on information currently known, the Company does not expect that the refunds ultimately ordered for the Refund Period would result in a material loss. This is primarily due to the fact that the FERC orders have stated that any refunds will be netted against unpaid amounts owed to the respective parties and the Company does not believe that refunds would exceed unpaid amounts owed to the Company.

***Pacific Northwest Refund Proceeding***

In July 2001, the FERC initiated a preliminary evidentiary hearing to develop a factual record as to whether prices for spot market sales of wholesale energy in the Pacific Northwest between December 25, 2000 and June 20, 2001 were just and reasonable. In June 2003, the FERC terminated the Pacific Northwest refund proceedings, after finding that the equities do not justify the imposition of refunds. In August 2007, the Ninth Circuit found that the FERC, in denying the request for refunds, had failed to take into account new evidence of market manipulation in the California energy market and its potential ties to the Pacific Northwest energy market and that such failure was arbitrary and capricious and, accordingly, remanded the case to the FERC, stating that the FERC's findings must be reevaluated in light of the evidence. In addition, the Ninth Circuit concluded that the FERC abused its discretion in denying potential relief for transactions involving energy that was purchased by the California Energy Resources Scheduling (CERS) in the Pacific Northwest and ultimately consumed in California. The Ninth Circuit expressly declined to direct the FERC to grant refunds. The Ninth Circuit denied petitions for rehearing by various parties, and remanded the case to the FERC in April 2009.

On October 3, 2011, the FERC issued an Order on Remand, finding that, in light of the Ninth Circuit's remand order, additional procedures are needed to address possible unlawful activity that may have influenced prices in the Pacific Northwest spot market during the period from December 25, 2000 through June 20, 2001. The Order establishes an evidentiary, trial-type hearing before an Administrative Law Judge (ALJ), and reopens the record to permit parties to present evidence of unlawful market activity during the relevant period. The Order also allows participants to supplement the record with additional evidence on CERS transactions in the Pacific Northwest spot market from January 18, 2001 to June 20, 2001. The Order states that parties seeking refunds must submit evidence demonstrating that specific unlawful market activity occurred, and must demonstrate that such activity directly affected negotiations with respect to the specific contract rate about which they complain. Simply alleging a general link between the dysfunctional spot market in California and the Pacific Northwest spot market will not be sufficient to establish a causal connection between a particular seller's alleged unlawful activities and the specific contract negotiations at issue. On July 11, 2012, a prehearing conference was held to discuss procedural issues. On July 16, 2012, the presiding administrative law judge issued an order adopting a procedural schedule. Claims are to be made known by August 17, 2012, and claimants' direct testimony is to be filed on September 21, 2012. Respondents' answering testimony is due November 28, 2012; staff's answering testimony is due January 15, 2013; and respondents' cross answering testimony is due February 13, 2013. Claimants' rebuttal testimony is due March 8, 2013. The hearing is scheduled to begin on April 15, 2013. On July 11, 2012, Avista Energy and Avista Utilities filed settlements of all issues in this docket with regard to the claims made by the City of Tacoma. On July 31, 2012, the FERC staff filed comments supporting the settlements. Reply comments on the settlements are due August 10, 2012.

Both Avista Utilities and Avista Energy were buyers and sellers of energy in the Pacific Northwest energy market during the period between December 25, 2000 and June 20, 2001 and, are subject to potential claims in this proceeding, and if refunds are ordered by the FERC with regard to any particular contract, could be liable to make payments. The Company cannot predict the outcome of this proceeding or the amount of any refunds that Avista Utilities or Avista Energy could be ordered to make. Therefore, the Company cannot predict the potential impact the outcome of this matter could ultimately have on the Company's results of operations, financial condition or cash flows.

***California Attorney General Complaint (the "Lockyer Complaint")***

In May 2002, the FERC conditionally dismissed a complaint filed in March 2002 by the California AG that alleged violations of the FPA 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

**AVISTA CORPORATION**

---

authority was flawed and, as a result, individual sellers should refund the difference between the rate charged and a just and reasonable rate. In May 2002, the FERC issued an order dismissing the complaint. In September 2004, the Ninth Circuit upheld the FERC's market-based rate authority, but held that the FERC erred in ruling that it lacked authority to order refunds for violations of its reporting requirement. The Court remanded the case for further proceedings.

In March 2008, the FERC issued an order establishing a trial-type hearing to address "whether any individual public utility seller's violation of the FERC's market-based rate quarterly reporting requirement led to an unjust and unreasonable rate for that particular seller in California during the 2000-2001 period." Purchasers in the California markets were given the opportunity to present evidence that "any seller that violated the quarterly reporting requirement failed to disclose an increased market share sufficient to give it the ability to exercise market power and thus cause its market-based rates to be unjust and unreasonable." In March 2010, the Presiding ALJ granted the motions for summary disposition and found that a hearing was "unnecessary" because the California AG, CPUC, PG&E and SCE "failed to apply the appropriate test to determine market power during the relevant time period." The judge determined that "[w]ithout a proper showing of market power, the California Parties failed to establish a prima facie case." In May 2011, the FERC affirmed "in all respects" the ALJ's decision. In June 2011, the California AG, CPUC, PG&E and SCE filed for rehearing of that order. Those rehearing requests were denied by the FERC on June 13, 2012. On June 20, 2012, the California AG, CPUC, PG&E and SCE filed a petition for review of the FERC's order with the Ninth Circuit.

Based on information currently known to the Company's management, the Company does not expect that this matter will have a material effect on its financial condition, results of operations or cash flows.

***Colstrip Generating Project Complaint***

In March 2007, two families that own property near the holding ponds from Units 3 & 4 of the Colstrip Generating Project (Colstrip) filed a complaint against the owners of Colstrip and Hydrometrics, Inc. in Montana District Court. Avista Corp. owns a 15 percent interest in Units 3 & 4 of Colstrip. The plaintiffs allege that the holding ponds and remediation activities have adversely impacted their property. They allege contamination, decrease in water tables, reduced flow of streams on their property and other similar impacts to their property. They also seek punitive damages, attorney's fees, an order by the court to remove certain ponds, and the forfeiture of profits earned from the generation of Colstrip. In September 2010, the owners of Colstrip filed a motion with the court to enforce a settlement agreement that would resolve all issues between the parties. In October 2011, the court issued an order, which enforces the settlement agreement. The plaintiffs have subsequently appealed the court's decision. Under the settlement, Avista Corp.'s portion of payment (which was accrued in 2010) to the plaintiffs was not material to its financial condition, results of operations or cash flows. Although the final resolution of this complaint remains uncertain, based on information currently known to the Company's management, the Company does not expect this complaint will have a material effect on its financial condition, results of operations or cash flows.

***Sierra Club and Montana Environmental Information Center Notice***

On July 25, 2012, the Sierra Club and the Montana Environmental Information Center (MEIC) provided notice to the owners of Colstrip of their intention to file a civil lawsuit against each of the owners (including Avista Corp.) for alleged violations of the federal Clean Air Act. In particular, the Sierra Club and the MEIC allege that certain permits were not obtained for activities they claim constitute upgrades to the plant and that the plant has exceeded certain emissions limits. There is currently not enough information to allow the Company to assess the probability or amount of a liability, if any, that may be incurred related to this matter.

***Harbor Oil Inc. Site***

Avista Corp. used Harbor Oil Inc. (Harbor Oil) for the recycling of waste oil and non-PCB transformer oil in the late 1980s and early 1990s. In June 2005, the Environmental Protection Agency (EPA) Region 10 provided notification to Avista Corp. and several other parties, as customers 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. and several other parties 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, which provides for joint and several liability. The initial indication from the EPA is that the site may be contaminated with PCBs, petroleum hydrocarbons, chlorinated solvents and heavy metals. Six potentially responsible parties, including Avista Corp., signed an Administrative Order on Consent with the EPA on May 31, 2007 to conduct a remedial investigation and feasibility study (RI/FS). The draft final RI/FS was submitted to the EPA in December 2011 and was accepted as pre-final in March 2012. The EPA indicated in their approval letter that they intend to recommend a finding of No Further Action later in 2012. The actual cleanup, if any, will not occur until the RI/FS is finalized and approved by the EPA. Based on the review of its records related to Harbor Oil, the Company does not believe it is a major

**AVISTA CORPORATION**

---

contributor to this potential environmental contamination based on the small volume of waste oil it delivered to the Harbor Oil site. As such, the Company does not expect that this matter will have a material effect on its financial condition, results of operations or cash flows. The Company has expensed its share of the RI/FS (\$0.5 million) for this matter.

***Spokane River Licensing***

The Company owns and operates six hydroelectric plants on the Spokane River. Five of these (Long Lake, Nine Mile, Upper Falls, Monroe Street, and Post Falls) are regulated under one 50-year FERC license issued in June 2009 and are referred to as the Spokane River Project. The sixth, Little Falls, is operated under separate Congressional authority and is not licensed by the FERC. The license incorporated the 4(e) conditions that were included in the December 2008 Settlement Agreement with the United States Department of Interior and the Coeur d'Alene Tribe, as well as the mandatory conditions that were agreed to in the Idaho 401 Water Quality Certifications and in the amended Washington 401 Water Quality Certification.

As part of the Settlement Agreement with the Washington Department of Ecology (DOE), the Company has participated in the Total Maximum Daily Load (TMDL) process for the Spokane River and Lake Spokane, the reservoir created by Long Lake Dam. On May 20, 2010, the EPA approved the TMDL and on May 27, 2010, the DOE filed an amended 401 Water Quality Certification with the FERC for inclusion into the license. The amended 401 Water Quality Certification includes the Company's level of responsibility, as defined in the TMDL, for low dissolved oxygen levels in Lake Spokane. The Company submitted a draft Water Quality Attainment Plan for Dissolved Oxygen to the DOE in May 2012. It is not possible to provide cost estimates at this time because the mitigation measures have not been fully identified or approved by the DOE. On July 16, 2010, the City of Post Falls and the Hayden Area Regional Sewer Board filed an appeal with the United States District Court for the District of Idaho with respect to the EPA's approval of the TMDL. The Company, the City of Coeur d'Alene, Kaiser Aluminum and the Spokane River Keeper subsequently moved to intervene in the appeal. In September 2011, the EPA issued a stay to the litigation that will be in effect until either the permits are issued and all appeals and challenges are complete or the court lifts the stay. The EPA and the Idaho Department of Environmental Quality (Idaho DEQ) are preparing draft National Pollutant Discharge Elimination System permits and the 401 Water Quality Certifications for the Idaho dischargers, respectively, which once issued will be released for a 30-day public comment period.

The IPUC and the WUTC approved the recovery of licensing costs through the general rate case settlements in 2009. The Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to implementing the license for the Spokane River Project.

***Cabinet Gorge Total Dissolved Gas Abatement Plan***

Dissolved atmospheric gas levels in the Clark Fork River 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. In 2002, the Company submitted a Gas Supersaturation Control Program (GSCP) to the Idaho DEQ and U.S. Fish and Wildlife Service (USFWS). This submission was part of the Clark Fork Settlement Agreement for licensing the use of Cabinet Gorge. The GSCP provided for the possible opening and modification of two diversion tunnels around Cabinet Gorge to allow streamflow to be diverted when flows are in excess of powerhouse capacity. In 2007, engineering studies determined that the tunnels would not sufficiently reduce Total Dissolved Gas (TDG). In consultation with the Idaho DEQ and the USFWS, the Company developed an addendum to the GSCP. The GSCP addendum abandons the concept to reopen the two diversion tunnels and requires the Company to evaluate a variety of different options to abate TDG. In March 2010, the FERC approved the GSCP addendum of preliminary design for alternative abatement measures. In the second quarter of 2011, the Company completed preliminary feasibility assessments for several alternative abatement measures and determined that two alternatives will be considered for continued development. Further analysis and review of these alternatives is expected to be completed through 2012. The Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to this issue.

***Fish Passage at Cabinet Gorge and Noxon Rapids***

In 1999, the USFWS listed bull trout as threatened under the Endangered Species Act. The Clark Fork Settlement Agreement describes programs intended to help restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, the Company is evaluating the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies led, in part, to the decision to move forward with development of permanent facilities, among other bull trout enhancement efforts. In 2009, the Company selected a contractor to design a permanent upstream passage facility at Cabinet Gorge. The Company anticipates that the design and cost estimates will be completed by the end of 2012 with construction taking place in 2013 and 2014.

**AVISTA CORPORATION**

---

In January 2010, the USFWS revised its 2005 designation of critical habitat for the bull trout to include the lower Clark Fork River as critical habitat. The Company believes its ongoing efforts through the Clark Fork Settlement Agreement continue to effectively address issues related to bull trout. The Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to fish passage at Cabinet Gorge and Noxon Rapids.

***Aluminum Recycling Site***

In October 2009, the Company (through its subsidiary Pentzer Venture Holdings II, Inc. (Pentzer)) received notice from the DOE proposing to find Pentzer liable for a release of hazardous substances under the Model Toxics Control Act, under Washington state law. Pentzer owns property that adjoins land owned by the Union Pacific Railroad (UPR). UPR leased their property to operators of a facility designated by the DOE as “Aluminum Recycling – Trentwood.” Operators of the UPR property maintained piles of aluminum “black dross,” which can be designated as a state-only dangerous waste in Washington State. In the course of its business, the operators placed a portion of the aluminum dross pile on the property owned by Pentzer. Pentzer does not believe it is a contributor to any environmental contamination associated with the dross pile, and submitted a response to the DOE’s proposed findings in November 2009. In December 2009, Pentzer received notice from the DOE that it had been designated as a potentially liable party for any hazardous substances located on this site. UPR completed a RI/FS Work Plan in June 2010. At that time, UPR requested a contribution from Pentzer towards the cost of performing the RI/FS and also an access agreement to investigate the material deposited on the Pentzer property. Pentzer concluded an access agreement with UPR in October 2010. UPR completed the RI/FS during 2011. Based on information currently known to the Company’s management, the Company does not expect this issue will have a material effect on its financial condition, results of operations or cash flows.

***Damages from Fire in Stevens County, Washington***

In August 2010, a fire in Stevens County, Washington occurred during a wind storm. The apparent cause of the fire may be a tree located outside of Avista Corp.’s right-of-way that came in contact with an electric line owned by Avista Corp. The fire area is a rural farm and timber landscape. The fire destroyed two residences and six outbuildings. In the second quarter of 2012, Avista Corp. settled claims with the property owners who sustained losses in an amount which was not material to its financial condition, results of operations or cash flows. The Company does not anticipate any further claims or lawsuits related to this matter.

***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 impact on its financial condition, results of operations or cash flows. It is possible that a change could occur in the Company’s estimates of the probability or amount of a liability being incurred. Such a change, should it occur, could be significant.

**NOTE 12. INFORMATION BY BUSINESS SEGMENTS**

The business segment presentation reflects the basis 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. Ecova is a provider of facility information and cost management services for multi-site customers throughout North America. The Other category, which is not a reportable segment, includes Spokane Energy, other investments and operations of various subsidiaries, as well as certain other operations of Avista Capital.

**AVISTA CORPORATION**

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

	Avista Utilities	Ecova	Other	Total Non- Utility	Intersegment Eliminations (1)	Total
<b>For the three months ended June 30, 2012:</b>						
Operating revenues	\$ 293,765	\$ 40,080	\$ 10,190	\$ 50,270	\$ (450)	\$ 343,585
Resource costs	135,992	—	—	—	—	135,992
Other operating expenses	63,601	34,750	9,678	44,428	(450)	107,579
Depreciation and amortization	27,754	3,359	212	3,571	—	31,325
Income from operations	46,028	1,971	300	2,271	—	48,299
Interest expense (2)	18,101	411	902	1,313	(89)	19,325
Income taxes	10,108	805	(553)	252	—	10,360
Net income attributable to Avista Corporation	18,020	1,149	(991)	158	—	18,178
Capital expenditures	62,705	1,083	39	1,122	—	63,827
<b>For the three months ended June 30, 2011:</b>						
Operating revenues	\$ 320,423	\$ 29,821	\$ 10,763	\$ 40,584	\$ (450)	\$ 360,557
Resource costs	155,776	—	—	—	—	155,776
Other operating expenses	68,700	24,424	8,635	33,059	(450)	101,309
Depreciation and amortization	26,407	1,638	204	1,842	—	28,249
Income from operations	49,841	3,759	1,924	5,683	—	55,524
Interest expense (2)	17,138	125	1,165	1,290	(4)	18,424
Income taxes	12,056	1,336	191	1,527	—	13,583
Net income attributable to Avista Corporation	21,034	1,841	126	1,967	—	23,001
Capital expenditures	49,228	961	165	1,126	—	50,354
<b>For the six months ended June 30, 2012:</b>						
Operating revenues	\$ 699,675	\$ 77,090	\$ 19,977	\$ 97,067	\$ (900)	\$ 795,842
Resource costs	347,004	—	—	—	—	347,004
Other operating expenses	126,958	70,524	18,056	88,580	(900)	214,638
Depreciation and amortization	55,072	6,195	380	6,575	—	61,647
Income from operations	125,109	371	1,541	1,912	—	127,021
Interest expense (2)	36,147	771	1,867	2,638	(183)	38,602
Income taxes	31,835	423	(760)	(337)	—	31,498
Net income attributable to Avista Corporation	57,497	322	(1,253)	(931)	—	56,566
Capital expenditures	120,476	2,225	41	2,266	—	122,742
<b>For the six months ended June 30, 2011:</b>						
Operating revenues	\$ 758,570	\$ 58,979	\$ 20,494	\$ 79,473	\$ (900)	\$ 837,143
Resource costs	403,897	—	—	—	—	403,897
Other operating expenses	128,382	48,430	16,325	64,755	(900)	192,237
Depreciation and amortization	52,259	3,302	407	3,709	—	55,968
Income from operations	129,340	7,247	3,762	11,009	—	140,349
Interest expense (2)	34,495	135	2,762	2,897	(377)	37,015
Income taxes	34,310	2,590	320	2,910	—	37,220
Net income attributable to Avista Corporation	61,151	3,548	220	3,768	—	64,919
Capital expenditures	98,882	1,276	324	1,600	—	100,482
<b>Total Assets:</b>						
As of June 30, 2012	\$3,729,148	\$383,826	\$103,381	\$487,207	\$ —	\$4,216,355
As of December 31, 2011	\$3,809,446	\$292,940	\$112,145	\$405,085	\$ —	\$4,214,531

(1) Intersegment eliminations reported as operating revenues and resource costs represent intercompany purchases and sales of electric capacity and energy. Intersegment eliminations reported as interest expense represent intercompany interest.

(2) Including interest expense to affiliated trusts.

[Table of Contents](#)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have reviewed the accompanying condensed consolidated balance sheet of Avista Corporation and subsidiaries (the "Company") as of June 30, 2012, and the related condensed consolidated statements of income and of comprehensive income, for the three-month and six-month periods ended June 30, 2012 and 2011, and of equity and redeemable noncontrolling interests, and cash flows for the six-month periods ended June 30, 2012 and 2011. These interim financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Avista Corporation and subsidiaries as of December 31, 2011, and the related consolidated statements of income, comprehensive income, equity and redeemable noncontrolling interests, and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2012, we expressed an unqualified opinion on those consolidated financial statements, which included an explanatory paragraph related to the adoption of accounting guidance for variable interest entities. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2011 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Deloitte & Touche LLP

Seattle, Washington  
August 7, 2012

**AVISTA CORPORATION****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Business Segments**

We have two reportable business segments as follows:

- **Avista Utilities** – an operating division of Avista Corp. that comprises our regulated utility operations. Avista Utilities generates, transmits and distributes electricity and distributes natural gas. The utility also engages in wholesale purchases and sales of electricity and natural gas.
- **Ecova** – an indirect subsidiary of Avista Corp. (79.0 percent owned as of June 30, 2012) provides energy efficiency and cost management programs and services for multi-site customers and utilities throughout North America. Ecova's primary product lines include expense management services for utility and telecom needs as well as strategic energy management and efficiency services that include procurement, conservation, performance reporting, financial planning, facility optimization and continuous monitoring, and energy efficiency program management for commercial enterprises and utilities.

We have other businesses, including sheet metal fabrication, venture fund investments and real estate investments, Spokane Energy, as well as certain other operations of Avista Capital. These activities do not represent a reportable business segment and are conducted by various direct and indirect subsidiaries of Avista Corp., including AM&D, doing business as METALfx.

The following table presents net income (loss) attributable to Avista Corp. for each of our business segments (and the other businesses) for the three and six months ended June 30 (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Avista Utilities	\$18,020	\$21,034	\$57,497	\$61,151
Ecova	1,149	1,841	322	3,548
Other	(991)	126	(1,253)	220
Net income attributable to Avista Corporation	<u>\$18,178</u>	<u>\$23,001</u>	<u>\$56,566</u>	<u>\$64,919</u>

**Executive Level Summary****Overall**

Net income attributable to Avista Corporation was \$18.2 million for three months ended June 30, 2012, a decrease from \$23.0 million for the three months ended June 30, 2011. This was due to a decrease in earnings at Avista Utilities (primarily due to reduced retail loads and an increase in depreciation and amortization, partially offset by a decrease in other operating expenses and the implementation of general rate increases), Ecova (primarily due to an increase in depreciation and amortization related to intangibles recorded in connection with the acquisitions of Prenova and LPB), as well as the net loss from the other businesses.

Net income attributable to Avista Corporation was \$56.6 million for six months ended June 30, 2012, a decrease from \$64.9 million for the six months ended June 30, 2011. This was due to a decrease in earnings at Avista Utilities (primarily due to reduced retail loads and an increase in depreciation and amortization, partially offset by a decrease in other operating expenses and the implementation of general rate increases), Ecova (primarily due to an increase in depreciation and amortization, as well as costs associated with completing and integrating the acquisitions of Prenova and LPB), as well as the net loss from the other businesses.

**Avista Utilities**

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

- weather conditions,
- regulatory decisions, allowing our utility to recover costs, including purchased power and fuel costs, on a timely basis, and to earn a reasonable return on investment,
- the price of natural gas in the wholesale market, including the effect on the price of fuel for generation,
- the price of electricity in the wholesale market, including the effects of weather conditions, natural gas prices and other factors affecting supply and demand, and
- the ability to obtain financing through the issuance of debt and/or equity securities, which can be affected by various factors including our credit ratings, interest rates and other capital market conditions.

In our utility operations, we regularly review the need for rate changes in each jurisdiction to improve the recovery of costs and capital investments in our generation, transmission and distribution systems. General rate increases went into effect in Idaho on October 1, 2011, in Washington on January 1, 2012, and in Oregon effective March 15, 2011, June 1, 2011 and June 1, 2012. On April 2, 2012, we filed electric and natural gas general rate increase requests in Washington.

**AVISTA CORPORATION**

---

Our utility net income was \$18.0 million for the three months ended June 30, 2012, a decrease from \$21.0 million for the three months ended June 30, 2011. The decrease in utility earnings was primarily due to a decrease in gross margin (operating revenues less resource costs) and partially due to increases in depreciation and amortization and interest expense. The decrease in gross margin was primarily due to warmer weather that reduced retail loads and associated revenues, partially offset by general rate increases. Heating degree days at Spokane were close to historical average for the second quarter of 2012, but decreased 21 percent as compared to the second quarter of 2011. The decrease in electric retail loads and associated revenues was also due in part to the continued weak economy and operational challenges at certain industrial customers. Other operating expenses decreased for the second quarter of 2012 as compared to the second quarter of 2011 primarily due to decreased electric maintenance costs (which included the regulatory deferral of \$5.0 million of maintenance costs) and outside services, partially offset by increased pensions and other postretirement benefits expense.

Our utility net income was \$57.5 million for the six months ended June 30, 2012, a decrease from \$61.2 million for the six months ended June 30, 2011. The decrease in utility earnings was primarily due to a decrease in gross margin (operating revenues less resource costs) and increases in depreciation and amortization and interest expense. The decrease in gross margin was primarily due to warmer weather that reduced retail loads, partially offset by general rate increases. Heating degree days at Spokane were close to historical average for the first half of 2012, but decreased 9 percent as compared to the first half of 2011. The decrease in electric retail loads and associated revenues was also due in part to the continued weak economy and operational challenges at certain industrial customers. Other operating expenses decreased for the six months ended June 30, 2012 as compared to the six months ended June 30, 2011 primarily due to decreased electric maintenance costs (which included the regulatory deferral of \$5.9 million of maintenance costs) and outside services, partially offset by increased pensions and other postretirement benefits expense.

We are making significant capital investments in generation, transmission and distribution systems to preserve and enhance service reliability for our customers and replace aging infrastructure. Utility capital expenditures were \$120.5 million for the six months ended June 30, 2012. We expect utility capital expenditures to be about \$250 million for the full year of 2012. These estimates of capital expenditures are subject to continuing review and adjustment (see discussion under “Avista Utilities Capital Expenditures”).

**Ecova**

Ecova had net income attributable to Avista Corporation of \$1.1 million for the three months ended June 30, 2012, a decrease from \$1.8 million for the three months ended June 30, 2011. This decrease was primarily due to an increase of \$1.7 million in depreciation and amortization due to intangibles recorded in connection with the acquisitions of Prenova and LPB. In addition, Ecova’s total operating expenses increased and revenue growth, excluding the acquisitions, was lower than would be expected on an annualized basis.

Ecova had net income attributable to Avista Corporation of \$0.3 million for the six months ended June 30, 2012, a decrease from \$3.5 million for the six months ended June 30, 2011. This decrease was due in part to \$1.5 million in costs of completing the acquisitions and integrating Prenova and LPB during the first quarter of 2012. Depreciation and amortization increased \$2.9 million due to intangibles recorded in connection with the acquisitions. In addition, Ecova’s total operating expenses increased and revenue growth, excluding the acquisitions of Prenova and LPB, was lower than would be expected on an annualized basis.

On November 30, 2011, Ecova acquired Prenova, an Atlanta-based energy management company. The cash paid for the acquisition of Prenova of \$35.6 million was funded primarily through borrowings under Ecova’s committed credit agreement.

On January 31, 2012, Ecova acquired LPB, a Dallas-based energy management company. The cash paid for the acquisition of LPB of \$50.6 million was funded by Ecova through \$25.0 million of borrowings under its committed credit agreement, a \$20.0 million equity infusion from existing shareholders (including Avista Capital and the other owners of Ecova), and available cash.

While we do not expect these acquisitions to have a significant impact on earnings for the full year of 2012, they increase Ecova’s market share and allow Ecova to offer its clients a broader range of services leading to potential future earnings growth.

The acquisition of Cadence Network in July 2008 was funded with the issuance of Ecova common stock. Under the transaction agreement, the previous owners of Cadence Network had a right to have their shares of Ecova common stock redeemed by Ecova during July 2011 or July 2012 if their investment in Ecova was not liquidated through either an initial public offering or sale of the business to a third party. These redemption rights were not exercised and expired effective July 31, 2012. As of June 30, 2012, there were redeemable noncontrolling interests of \$41.6 million related to these redemption rights, which was reclassified to equity effective July 31, 2012.

**AVISTA CORPORATION**

---

Consistent with recent years, Ecova plans to continue to grow organically and potentially through strategic acquisitions. Ecova's acquisitions have been funded through internally generated cash, borrowings under Ecova's credit facility and the most recent acquisition of LPB was funded in part through an equity infusion from existing shareholders. If Ecova's capital needs exceed its credit facility capacity, it will require additional equity infusion from existing shareholders and/or new funding sources.

We may seek to monetize all or part of our investment in Ecova in the future. The value of a potential monetization depends on future market conditions, growth of the business and other factors. This may provide access to public market capital and provide potential liquidity to Avista Corp. and the other owners of Ecova. There can be no assurance that such a transaction will be completed.

***Other Businesses***

The net loss for these operations was \$1.0 million for the three months ended June 30, 2012 compared to net income of \$0.1 million for the three months ended June 30, 2011. The net loss for these operations was \$1.3 million for the six months ended June 30, 2012 compared to net income of \$0.2 million for the six months ended June 30, 2011. The decline in results was primarily due to increased litigation costs for the remaining contracts and previous operations of Avista Energy, as well as a net loss on investments.

***Liquidity and Capital Resources***

We need to access long-term capital markets from time to time to finance capital expenditures, repay maturing long-term debt and obtain additional working capital. Our ability to access capital on reasonable terms is subject to numerous factors, many of which, including market conditions, are beyond our control. If we were unable to obtain capital on reasonable terms, it could limit or eliminate our ability to finance capital expenditures and repay maturing long-term debt. Our liquidity needs could exceed our short-term credit availability and lead to defaults on various financing arrangements. We would also likely be prohibited from paying dividends on our common stock.

We have a committed line of credit with various financial institutions in the total amount of \$400.0 million with an expiration date of February 2017. As of June 30, 2012, there were \$91.0 million of cash borrowings and \$25.1 million in letters of credit outstanding. As of June 30, 2012, we had \$283.9 million of available liquidity under this line of credit.

As of June 30, 2012, Ecova had a \$60.0 million committed line of credit agreement with a financial institution that was scheduled to expire in April 2014, which was fully utilized. In July 2012, Ecova entered into a new five-year \$125.0 million committed line of credit agreement with various financial institutions that replaced its \$60.0 million committed line of credit agreement.

In June 2012, we entered into a bond purchase agreement with certain institutional investors in the private placement market for the purpose of issuing \$80.0 million of 4.23 percent First Mortgage Bonds due in 2047. The issuance of the bonds will occur at closing in November 2012. The net proceeds from the sale of the new bonds will be used to repay a portion of the borrowings outstanding under our \$400.0 million committed line of credit and for general corporate purposes.

In May 2012, we cash settled interest rate swap contracts (notional amount of \$75.0 million) and paid a total of \$18.5 million. The interest rate swap contracts were settled in connection with the pricing of \$80.0 million of First Mortgage Bonds as described above. Upon settlement of the interest rate swaps, the regulatory asset or liability (included as part of long-term debt) is amortized as a component of interest expense over the life of the forecasted interest payments.

We expect to issue up to \$45 million of common stock from time to time in 2012 (with the majority in the second half of the year) in order to maintain our capital structure at an appropriate level for our business. After considering the issuances of long-term debt and common stock during 2012, we expect net cash flows from operating activities, together with cash available under our \$400.0 million committed line of credit agreement, to provide adequate resources to fund:

- capital expenditures,
- dividends, and
- other contractual commitments.

**Avista Utilities – Regulatory Matters**

***General Rate Cases***

We regularly review the need for electric and natural gas rate changes in each state in which we provide service. We will continue to file for rate adjustments to:

- provide for recovery of operating costs and capital investments, and
- provide the opportunity to improve our earned returns as allowed by regulators.

**AVISTA CORPORATION**

---

With regards to the timing and plans for future filings, the assessment of our need for rate relief and the development of rate case plans takes into consideration short-term and long-term needs, as well as specific factors that can affect the timing of rate filings. Such factors include, but are not limited to, in-service dates of major capital investments and the timing of changes in major revenue and expense items. We filed general rate cases in Washington in May 2011 (which was settled with new rates effective January 1, 2012) and in Idaho in July 2011 (which was settled with new rates effective October 1, 2011). We filed a general rate case in Washington in April 2012 and we expect to file a general rate case in Idaho in the second half of 2012.

***Washington General Rate Cases***

In December 2011, the WUTC approved a settlement agreement in our electric and natural gas general rate cases filed in May 2011. As agreed to in the settlement agreement, base electric rates for our Washington customers increased by an average of 4.6 percent, which was designed to increase annual revenues by \$20.0 million. Base natural gas rates for our Washington customers increased by an average of 2.4 percent, which was designed to increase annual revenues by \$3.75 million. The new electric and natural gas rates became effective on January 1, 2012. No capital structure ratios or cost of capital components were specified in the settlement agreement.

The settlement agreement also provides for the deferral of certain generation plant maintenance costs. In order to address the variability in year-to-year maintenance costs, beginning in 2011, we are deferring changes in maintenance costs related to our Coyote Springs 2 natural gas-fired generation plant and our 15 percent ownership interest in Units 3&4 of the Colstrip generation plant. We compare actual, non-fuel, maintenance expenses for the Coyote Springs 2 and Colstrip plants with the amount of baseline maintenance expenses used to establish base retail rates, and defer the difference. The deferral will occur annually, with no carrying charge, with deferred costs being amortized over a four-year period, beginning in the year following the period costs are deferred. The amount of expense to be requested for recovery in future general rate cases will be the actual maintenance expense recorded in the test period, less any amount deferred during the test period, plus the amortization of previously deferred costs. Total net deferred costs under this mechanism in Washington were a regulatory asset of \$3.4 million as of June 30, 2012 compared to a regulatory liability of \$0.5 million as of December 31, 2011.

On April 2, 2012, we filed electric and natural gas general rate cases with the WUTC. We have requested an overall increase in billed electric rates of 8.8 percent (9.0 percent in base rates) and an overall increase in billed natural gas rates of 6.8 percent (7.0 percent in base rates). The filings are designed to increase annual electric revenues by \$41.0 million and increase annual natural gas revenues by \$10.1 million. Our requests are based on a proposed overall rate of return of 8.25 percent, with a common equity ratio of 48.4 percent and a 10.9 percent return on equity. As part of the filing, we have requested a one-year rate decrease of 2.9 percent, designed to reduce electric revenues by \$13.6 million, to rebate to customers the deferred liability for the Energy Recovery Mechanism (ERM) for 2011. This rate decrease for the ERM would not have any impact on Avista Corp.'s net income. The net effect of the general rate increase request of 8.8 percent coupled with the ERM rebate of 2.9 percent is an overall increase in billed electric rates of 5.9 percent. The WUTC has up to 11 months to review the filings and issue a decision.

As part of this general rate case, we have asked the WUTC to address the delay between the time when costs are incurred and the time when new rates are reviewed and approved by the WUTC and go into effect. This delay is referred to as regulatory lag. We contracted with a consultant to develop an attrition study to determine the annual revenue short-fall related to regulatory lag. We proposed an attrition adjustment in this general rate case filing, based on the attrition study, which is designed to eliminate the annual revenue short-fall related to regulatory lag.

As part of the April 2, 2012 Washington general rate case filing, we have proposed certain changes to the ERM as discussed at "Power Cost Deferrals and Recovery Mechanisms."

***Idaho General Rate Cases***

In September 2011, the IPUC approved a settlement agreement in our general rate case filed in July 2011. The new electric and natural gas rates became effective on October 1, 2011. As agreed to in the settlement agreement, base electric rates for our Idaho customers increased by an average of 1.1 percent, which is designed to increase annual revenues by \$2.8 million. Base natural gas rates for our Idaho customers increased by an average of 1.6 percent, which is designed to increase annual revenues by \$1.1 million.

As part of the settlement agreement, we agreed not to file a general rate case seeking a change in base electric or natural gas rates effective prior to April 1, 2013. This does not preclude us from filing annual rate adjustments such as the PCA and the PGA.

The settlement agreement also provides for the deferral of certain generation plant operation and maintenance costs. In order to address the variability in year-to-year operation and maintenance costs, beginning in 2011, we are deferring changes in operation and maintenance costs related to the Coyote Springs 2 natural gas-fired generation plant and our 15 percent ownership interest in Units 3&4 of the Colstrip generation plant. We compare actual, non-fuel, operation and maintenance expenses for the Coyote Springs 2 and Colstrip plants with the amount of expenses authorized for recovery in base rates in the applicable deferral year, and defer the difference from that currently

**AVISTA CORPORATION**

---

authorized. The deferral will occur annually, with no carrying charge, with deferred costs being amortized over a three-year period, beginning in the year following the period costs are deferred. The amount of expense to be requested for recovery in future general rate cases will be the actual operation and maintenance expense recorded in the test period, less any amount deferred during the test period, plus the amortization of previously deferred costs. Total net deferred costs under this mechanism in Idaho were a regulatory asset of \$2.2 million as of June 30, 2012 compared to a regulatory asset of \$0.1 million as of December 31, 2011.

***Oregon General Rate Cases***

In March 2011, the OPUC approved an all-party settlement stipulation in our general rate case that was filed in September 2010. The settlement provides for an overall rate increase of 3.1 percent for our Oregon customers, designed to increase annual revenues by \$3.0 million. Part of the rate increase became effective March 15, 2011, with the remaining increase effective June 1, 2011. An additional rate adjustment designed to increase revenues by \$0.5 million became effective on June 1, 2012 to recover capital costs associated with certain reinforcement and replacement projects, having demonstrated that such projects were complete by November 1, 2011, and the costs incurred were prudent. In addition, rates increased by an additional \$0.5 million, from June 1, 2012 through May 31, 2013, to recover the November 2011 through May 2012 deferred revenue requirement.

***Proposed Electric Decoupling—Washington***

In the September 2011 Washington general rate case settlement (which was approved by the WUTC in December 2011), one party, the Northwest Energy Coalition (NWECC), did not sign the agreement and continued to pursue an electric decoupling mechanism through a separate procedural schedule. On May 14, 2012, the WUTC consolidated this issue into our April 2012 Washington general rate case. Decoupling would sever the link between actual kWh sales and the recovery of our fixed costs. In summary, the NWECC proposes that actual fixed cost recovery per customer be compared to authorized fixed cost recovery per customer, and that any difference be deferred for later surcharge or rebate to customers. The current schedule for the 2012 Washington general rate case would provide for a decision by the WUTC in the first half of 2013. If the WUTC adopted a decoupling mechanism, this could affect future rates and our results of operations. However, there are many variables that could be incorporated into a decoupling mechanism, and we cannot currently predict the design of the mechanism, if any, the WUTC might ultimately adopt or the effect that any mechanism adopted may have on future rates or our results of operations.

***Purchased Gas Adjustments***

Effective March 1, 2012, natural gas rates decreased 6.4 percent in Washington and 6.0 percent in Idaho. Effective October 1, 2011, natural gas rates increased 1.0 percent in Idaho. Effective November 1, 2011, natural gas rates increased 1.0 percent in Washington, while decreasing 0.2 percent in Oregon. In Oregon, we absorb (gain or loss) 10 percent of the difference between actual and projected gas costs for supply that is not hedged. Total net deferred natural gas costs were a liability of \$16.2 million as of June 30, 2012, compared to \$12.1 million as of December 31, 2011. PGAs are designed to pass through changes in natural gas costs to our customers with no change in gross margin (operating revenues less resource costs) or net income.

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

The Energy Recovery Mechanism (ERM) is an accounting method used to track certain differences between actual power supply costs, net of the margin on wholesale sales and sales of fuel, and the amount included in base retail rates for our Washington customers. Total net deferred power costs under the ERM were a liability of \$16.7 million as of June 30, 2012 compared to \$12.9 million as of December 31, 2011. As part of our April 2, 2012 general rate case filing, we have requested a one-year rate decrease of 2.9 percent to rebate to customers the 2011 deferred liability for the ERM.

The difference in net power supply costs under the ERM primarily results from changes in:

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

Under the ERM, we absorb the cost or receive the benefit from the initial amount of power supply costs in excess of or below the level in retail rates, which is referred to as the deadband. The annual (calendar year) deadband amount is currently \$4.0 million. We incur the cost of, or receive the benefit from, 100 percent of this initial power supply cost variance. We share annual power supply cost variances between \$4.0 million and \$10.0 million with customers. There is a 50 percent customers/50 percent Company sharing when actual power supply expenses are higher (surcharge to customers) than the amount included in base retail rates within this band. There is a 75 percent customers/25 percent Company sharing when actual power supply expenses are lower (rebate to customers) than the amount included in base retail rates within this band. To the extent that the annual power supply cost variance from the amount included in base rates exceeds \$10.0 million, there is a 90 percent customers/10 percent Company sharing of the cost variance.

**AVISTA CORPORATION**

The following is a summary of the ERM:

<u>Annual Power Supply Cost Variability</u>	<u>Deferred for Future Surcharge or Rebate to Customers</u>	<u>Expense or Benefit to the Company</u>
+/- \$0 - \$4 million	0%	100%
+ between \$4 million - \$10 million	50%	50%
- between \$4 million - \$10 million	75%	25%
+/- excess over \$10 million	90%	10%

Under the ERM, we make an annual filing on or before April 1 of each year to provide the opportunity for the WUTC staff and other interested parties to review the prudence of and audit the ERM deferred power cost transactions for the prior calendar year. We made our annual filing on March 29, 2012. 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. The 2011 ERM deferred power cost transactions were approved by an order from the WUTC.

Under the terms of a prior settlement, we were required to make a filing (no sooner than June 2011), to allow all interested parties the opportunity to review the ERM, and make recommendations to the WUTC related to the continuation, modification or elimination of the ERM.

As part of our April 2, 2012 general rate case filing we proposed a continuation and modification of the ERM. Among the proposed changes is a proposal for the entire power supply cost variance to be shared 90 percent customers/10 percent Company, consistent with our Power Cost Adjustment (PCA) mechanism in Idaho. We have also proposed that customers' rates be adjusted on an annual basis to provide a surcharge or rebate to customers for any deferral balance resulting from the ERM in the prior calendar year.

We have a PCA mechanism in Idaho that allows us to modify electric rates on October 1 of each year with IPUC approval. Under the PCA mechanism, we defer 90 percent of the difference between certain actual net power supply expenses and the amount included in base retail rates for our Idaho customers. The October 1 rate adjustments recover or rebate power supply costs deferred during the preceding July-June twelve-month period. Total net power supply costs deferred under the PCA mechanism were a regulatory liability of \$2.4 million as of June 30, 2012 compared to \$0.7 million as of December 31, 2011.

***Natural Gas Safety Regulations***

On February 3, 2012, President Obama signed into law the "Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011" mandating new regulations be created to address public safety concerns. Regulations include validation of pipeline records for transmission pipelines, evaluation of transmission pipelines for automatic shut-off valves, consideration of increased "high consequence area" boundaries for transmission pipelines, increased installation of excess flow valves on gas service piping, as well as increased scrutiny on existing emergency preparedness plans, quality assurance plans and damage prevention programs, and broader federal oversight including broader use of fines and penalties to pipeline operators. We are evaluating the Act and cannot predict the impact the Act may ultimately have on our operations.

***Results of Operations***

The following provides an overview of changes in our Condensed Consolidated Statements of Income. More detailed explanations are provided, particularly for operating revenues and operating expenses, in the business segment discussions (Avista Utilities, Ecova and the other businesses) that follow this section.

***Three months ended June 30, 2012 compared to the three months ended June 30, 2011***

Utility revenues decreased \$26.7 million, after elimination of intracompany revenues of \$12.4 million in the second quarter of 2012 and \$23.8 million in the second quarter of 2011. Including intracompany revenues, electric revenues decreased \$6.4 million and natural gas revenues decreased \$31.6 million. Retail electric revenues decreased \$2.9 million due to a decrease in volumes sold primarily caused by warmer weather during the second quarter of 2012 compared to 2011, partially offset by general rate increases. In addition to warmer weather, retail sales volumes declined due in part to the continued weak economy and lower usage at certain industrial customers. Sales of fuel decreased \$10.6 million (reflecting decreased sales of natural gas fuel not used in generation). These decreases in retail electric revenues and sales of fuel were partially offset by an increase in wholesale electric revenues of \$6.5 million (primarily due to an increase in volumes sold). Retail natural gas revenues decreased \$11.2 million due to a decrease in volumes caused by warmer weather, and wholesale natural gas revenues decreased \$20.5 million (due to a decrease in wholesale prices, partially offset by an increase in wholesale volumes).

Non-utility revenues increased \$9.7 million to \$50.3 million primarily as a result of the acquisitions of Prenova effective November 30, 2011 and LPB effective January 31, 2012.

Utility resource costs decreased \$19.8 million, after elimination of intracompany resource costs of \$12.4 million in the second quarter of 2012 and \$23.8 million in the second quarter of 2011. Including intracompany resource costs,

**AVISTA CORPORATION**

---

electric resource costs decreased \$2.8 million and natural gas resource costs decreased \$28.3 million. The decrease in electric resource costs was primarily due to a decrease in other fuel costs (represents fuel that was purchased for generation but was later sold when conditions indicated that it was not economical to use the fuel for generation as part of the resource optimization process) and fuel costs, partially offset by an increase in purchased power costs. The decrease in natural gas resource costs was primarily due to a decrease in natural gas purchased due to a decrease in prices, partially offset by an increase in volumes.

Utility other operating expenses decreased \$5.1 million primarily due to decreased electric maintenance costs (which includes the regulatory deferral of \$5.0 million of maintenance costs) and outside services, partially offset by increased pensions and other postretirement benefits expense.

Utility depreciation and amortization increased \$1.3 million driven by additions to utility plant.

Non-utility other operating expenses increased \$11.4 million primarily due to an increase of \$10.3 million for Ecova reflecting increased costs necessary for business growth and the acquisitions of Prenova and LPB. The remaining increase was primarily due to litigation costs for the remaining contracts and previous operations of Avista Energy.

Non-utility depreciation and amortization increased \$1.7 million primarily due to the amortization of intangibles recorded in connection with the acquisitions of Prenova and LPB.

Interest expense increased \$0.9 million primarily due to the issuance of long-term debt in December 2011 that increased the balance of long-term debt outstanding.

Income taxes decreased \$3.2 million and our effective tax rate was 35.9 percent for the three months ended June 30, 2012 compared to 36.6 percent for the three months ended June 30, 2011. This decrease in expense was primarily due to a decrease in income before income taxes.

***Six months ended June 30, 2012 compared to the six months ended June 30, 2011***

Utility revenues decreased \$58.9 million, after elimination of intracompany revenues of \$40.0 million for the six months ended June 30, 2012 and \$40.8 million for the six months ended June 30, 2011. Including intracompany revenues, electric revenues decreased \$22.3 million and natural gas revenues decreased \$37.4 million. Retail electric revenues decreased \$6.3 million due to a decrease in volumes sold primarily caused by warmer weather during the six months ended June 30, 2012 compared to 2011, partially offset by general rate increases. In addition to warmer weather, retail sales volumes declined due in part to the continued weak economy and lower usage at certain industrial customers. Sales of fuel decreased \$29.9 million (reflecting higher usage of our thermal generating plants and decreased sales of natural gas fuel not used in generation). These decreases in retail electric revenues and sales of fuel were partially offset by an increase in wholesale electric revenues of \$12.5 million (due to an increase in volumes, partially offset by a decrease in wholesale prices). Retail natural gas revenues decreased \$15.6 million due to a decrease in volumes caused by warmer weather, while wholesale natural gas revenues decreased \$21.2 million (due to a decrease in wholesale prices, partially offset by an increase in wholesale volumes).

Non-utility revenues increased \$17.6 million to \$97.1 million primarily as a result of the acquisitions of Prenova effective November 30, 2011 and LPB effective January 31, 2012.

Utility resource costs decreased \$56.9 million, after elimination of intracompany resource costs of \$40.0 million for the six months ended June 30, 2012 and \$40.8 million for the six months ended June 30, 2011. Including intracompany resource costs, electric resource costs decreased \$22.0 million and natural gas resource costs decreased \$35.7 million. The decrease in electric resource costs was primarily due to a decrease in other fuel costs (represents fuel that was purchased for generation but was later sold when conditions indicated that it was not economical to use the fuel for generation as part of the resource optimization process) and the amortization of deferred power supply costs, partially offset by an increase in fuel costs (due to higher thermal generation) and power purchased. The decrease in natural gas resource costs was primarily due to a decrease in natural gas purchased due to a decrease in prices, partially offset by an increase in volumes.

Utility other operating expenses decreased \$1.4 million primarily due to decreased electric maintenance costs (which includes the regulatory deferral of \$5.9 million of maintenance costs) and outside services, partially offset by increased pensions and other postretirement benefits expense.

Utility depreciation and amortization increased \$2.8 million driven by additions to utility plant.

Non-utility other operating expenses increased \$23.8 million primarily due to an increase of \$22.1 million for Ecova reflecting increased costs necessary for business growth and the acquisitions of Prenova and LPB, including transaction and integration costs of \$1.5 million. The remaining increase was primarily due to litigation costs for the remaining contracts and previous operations of Avista Energy.

Non-utility depreciation and amortization increased \$2.9 million primarily due to the amortization of intangibles recorded in connection with the acquisitions of Prenova and LPB.

**AVISTA CORPORATION**

Interest expense increased \$1.6 million primarily due to the issuance of long-term debt in December 2011 that increased the balance of long-term debt outstanding.

Income taxes decreased \$5.7 million and our effective tax rate was 35.7 percent for the six months ended June 30, 2012 compared to 36.1 percent for the six months ended June 30, 2011. This decrease in expense was primarily due to a decrease in income before income taxes.

**Avista Utilities**

**Three months ended June 30, 2012 compared to the three months ended June 30, 2011**

Net income for Avista Utilities was \$18.0 million for the three months ended June 30, 2012, a decrease from \$21.0 million for the three months ended June 30, 2011. Avista Utilities' income from operations was \$46.0 million for the three months ended June 30, 2012 compared to \$49.8 million for the three months ended June 30, 2011. The decrease in net income and income from operations was primarily due to a decrease in gross margin (operating revenues less resource costs), and an increase in depreciation and amortization, partially offset by a decrease in other operating expenses. The decrease in net income from Avista Utilities was also due to an increase in interest expense.

The following table presents our operating revenues, resource costs and resulting gross margin for the three months ended June 30 (dollars in thousands):

	Electric		Natural Gas		Intracompany		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
Operating revenues	\$ 219,847	\$ 226,277	\$ 86,281	\$ 117,901	\$ (12,363)	\$ (23,755)	\$ 293,765	\$ 320,423
Less: resource costs	88,768	91,608	59,587	87,923	(12,363)	(23,755)	135,992	155,776
Gross margin	<u>\$ 131,079</u>	<u>\$ 134,669</u>	<u>\$ 26,694</u>	<u>\$ 29,978</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 157,773</u>	<u>\$ 164,647</u>

Avista Utilities' operating revenues decreased \$26.7 million and resource costs decreased \$19.8 million, which resulted in a decrease of \$6.9 million in gross margin. The gross margin on electric sales decreased \$3.6 million and the gross margin on natural gas sales decreased \$3.3 million. The decrease in electric and natural gas gross margin was primarily due to warmer weather that reduced retail loads, partially offset by general rate increases. In addition to warmer weather, electric gross margin decreased due in part to the continued weak economy and lower usage at certain industrial customers. For the three months ended June 30, 2012, we recognized a benefit of \$1.0 million under the ERM in Washington compared to an expense of \$0.2 million for the three months ended June 30, 2011.

Intracompany revenues and resource costs represent purchases and sales of natural gas between our natural gas distribution operations and our electric generation operations (as fuel for our generation plants). These transactions are eliminated in the presentation of total results for Avista Utilities and in the consolidated financial statements.

The following table presents our utility 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	
	2012	2011	2012	2011
Residential	\$ 63,460	\$ 67,136	722	766
Commercial	67,473	65,998	725	731
Industrial	29,766	30,600	517	534
Public street and highway lighting	1,823	1,714	7	6
Total retail	<u>162,522</u>	<u>165,448</u>	<u>1,971</u>	<u>2,037</u>
Wholesale	21,176	14,691	1,074	773
Sales of fuel	30,017	40,620	—	—
Other	6,132	5,518	—	—
Total	<u>\$ 219,847</u>	<u>\$ 226,277</u>	<u>3,045</u>	<u>2,810</u>

Retail electric revenues decreased \$2.9 million due to a decrease in total MWhs sold (decreased revenues \$5.5 million) primarily due to a decrease in use per customer as a result of warmer weather, and partially due to the continued weak economy and lower usage at certain industrial customers. This was partially offset by an increase in revenue per MWh (increased revenues \$2.6 million). Heating degree days at Spokane were close to historical average for the second quarter of 2012, but decreased 21 percent as compared to the second quarter of 2011. Compared to the second quarter of 2011, residential electric use per customer decreased 6 percent. The increase in revenue per MWh was primarily due to the Washington and Idaho general rate increases.

Wholesale electric revenues increased \$6.5 million primarily due to an increase in sales volumes (increased revenues \$6.0 million), and partially due to an increase in sales prices (increased revenues \$0.5 million). The increase in sales volumes was primarily due to increased wholesale power optimization and lower than expected retail sales.

When electric wholesale market prices are below the cost of operating our natural gas-fired thermal generating units, we sell the natural gas purchased for generation in the wholesale market rather than operate the generating units.

**AVISTA CORPORATION**

The revenues from sales of fuel decreased \$10.6 million due to a decrease in sales of natural gas fuel as part of thermal generation resource optimization. In the second quarter of 2012, \$2.1 million of these sales were made to our natural gas operations and are included as intracompany revenues and resource costs. In the second quarter of 2011, \$6.5 million of these sales were made to our natural gas operations.

The net margin on wholesale sales and sales of fuel is applied to reduce or increase resource costs as accounted for under the ERM, the PCA mechanism, and in general rate cases as part of base power supply costs.

The following table presents our utility 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	
	2012	2011	2012	2011
Residential	\$33,450	\$ 40,608	29,802	36,332
Commercial	16,664	20,337	18,618	22,053
Interruptible	483	598	927	1,040
Industrial	807	1,061	1,139	1,392
Total retail	51,404	62,604	50,486	60,817
Wholesale	31,492	52,015	154,731	124,989
Transportation	1,668	1,637	35,731	35,526
Other	1,717	1,645	91	99
Total	<u>\$86,281</u>	<u>\$117,901</u>	<u>241,039</u>	<u>221,431</u>

Retail natural gas revenues decreased \$11.2 million primarily due to a decrease in volumes (decreased revenues \$10.5 million), and partially due to slightly lower retail rates (decreased revenues \$0.7 million). We sold less retail natural gas in the second quarter of 2012 as compared to the second quarter of 2011 primarily due to warmer weather. Compared to the second quarter of 2011, residential natural gas use per customer decreased 19 percent and commercial use per customer decreased 16 percent.

Wholesale natural gas revenues decreased \$20.5 million due to a decrease in prices (decreased revenues \$26.0 million), partially offset by an increase in volumes (increased revenues \$5.5 million). We plan for sufficient natural gas capacity to serve our retail customers on a theoretical peak day. As such, on nonpeak days we generally have more pipeline and storage capacity than what is needed. We engage in optimization of available interstate pipeline transportation and storage capacity through wholesale purchases and sales of natural gas to generate economic value that offsets net natural gas costs. We hedge against expected natural gas volumes with forward purchases. In some situations, customer demand is below the amount hedged and we sell natural gas in excess of load requirements. In the second quarter of 2012, \$10.3 million of these sales were made to our electric generation operations and are included as intracompany revenues and resource costs. In the second quarter of 2011, \$17.3 million of these sales were made to our electric generation operations. Differences between revenues and costs from sales of resources in excess of retail load requirements and from resource optimization are accounted for through the PGA mechanisms.

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

	Electric Customers		Natural Gas Customers	
	2012	2011	2012	2011
Residential	318,104	315,952	286,232	284,165
Commercial	39,814	39,557	33,775	33,538
Interruptible	—	—	36	35
Industrial	1,400	1,372	262	253
Public street and highway lighting	493	453	—	—
Total retail customers	<u>359,811</u>	<u>357,334</u>	<u>320,305</u>	<u>317,991</u>

The following table presents our utility resource costs for the three months ended June 30 (dollars in thousands):

	<u>2012</u>	<u>2011</u>
Electric resource costs:		
Power purchased	\$38,573	\$29,236
Power cost amortizations, net	3,958	2,284
Fuel for generation	6,890	12,875
Other fuel costs	30,277	39,312
Other regulatory amortizations, net	4,630	3,724
Other electric resource costs	4,440	4,177
Total electric resource costs	<u>\$88,768</u>	<u>\$91,608</u>

**AVISTA CORPORATION**

	2012	2011
Natural gas resource costs:		
Natural gas purchased	\$ 57,459	\$ 88,279
Natural gas cost amortizations, net	767	(2,087)
Other regulatory amortizations, net	1,361	1,731
Total natural gas resource costs	<u>59,587</u>	<u>87,923</u>
Intracompany resource costs	(12,363)	(23,755)
Total resource costs	<u>\$135,992</u>	<u>\$155,776</u>

Power purchased increased \$9.3 million due to an increase in the volume of power purchases (increased costs \$10.0 million), partially offset by a decrease in wholesale prices (decreased costs \$0.7 million).

Net amortization of deferred power costs was \$4.0 million for the second quarter of 2012 compared to \$2.3 million for the second quarter of 2011. During the second quarter of 2012, we recovered (collected as revenue) \$0.6 million of previously deferred power costs in Idaho through the PCA surcharge. The Washington ERM surcharge was eliminated in February 2010, since the previous balance of deferred power costs had been recovered. During the second quarter of 2012, actual power supply costs were below the amount included in base retail rates and we deferred \$3.0 million in Washington and \$0.4 million in Idaho for potential future rebate to customers.

Fuel for generation decreased \$6.0 million primarily due to a decrease in thermal generation and natural gas fuel prices.

Other fuel costs decreased \$9.0 million. This represents fuel that was purchased for generation but was later sold when conditions indicated that it was not economical to use the fuel for generation, as part of the resource optimization process. The associated revenues are reflected as sales of fuel.

The expense for natural gas purchased decreased \$30.8 million due to a decrease in the price of natural gas (decreased costs \$34.3 million), partially offset by an increase in total therms purchased (increased costs \$3.5 million). Total therms purchased increased due to an increase in wholesale sales with the balancing of loads and resources as part of the natural gas procurement and resource optimization process. We engage in optimization of available interstate pipeline transportation and storage capacity through wholesale purchases and sales of natural gas to generate economic value that offsets net natural gas costs.

**Six months ended June 30, 2012 compared to the six months ended June 30, 2011**

Net income for Avista Utilities was \$57.5 million for the six months ended June 30, 2012, a decrease from \$61.2 million for the six months ended June 30, 2011. Avista Utilities' income from operations was \$125.1 million for the six months ended June 30, 2012 compared to \$129.3 million for the six months ended June 30, 2011. The decrease in net income and income from operations was primarily due to a decrease in gross margin (operating revenues less resource costs), and depreciation and amortization, partially offset by a decrease in other operating expenses. The decrease in net income from Avista Utilities was also due to an increase in interest expense.

The following table presents our operating revenues, resource costs and resulting gross margin for the six months ended June 30 (dollars in thousands):

	Electric		Natural Gas		Intracompany		Total	
	2012	2011	2012	2011	2012	2011	2012	2011
Operating revenues	\$475,903	\$498,228	\$263,781	\$301,133	\$(40,009)	\$(40,791)	\$699,675	\$758,570
Less: resource costs	206,700	228,657	180,313	216,031	(40,009)	(40,791)	347,004	403,897
Gross margin	<u>\$269,203</u>	<u>\$269,571</u>	<u>\$ 83,468</u>	<u>\$ 85,102</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$352,671</u>	<u>\$354,673</u>

Avista Utilities' operating revenues decreased \$58.9 million and resource costs decreased \$56.9 million, which resulted in a decrease of \$2.0 million in gross margin. The gross margin on electric sales decreased \$0.4 million and the gross margin on natural gas sales decreased \$1.6 million. The decrease in electric and natural gas gross margin was primarily due to warmer weather that reduced retail loads, partially offset by general rate increases. In addition to warmer weather, electric gross margin decreased due in part to the continued weak economy and lower usage at certain industrial customers. For the six months ended June 30, 2012, we recognized a benefit of \$5.1 million under the ERM in Washington compared to \$4.7 million for the six months ended June 30, 2011.

Intracompany revenues and resource costs represent purchases and sales of natural gas between our natural gas distribution operations and our electric generation operations (as fuel for our generation plants). These transactions are eliminated in the presentation of total results for Avista Utilities and in the consolidated financial statements.

**AVISTA CORPORATION**

The following table presents our utility 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	
	2012	2011	2012	2011
Residential	\$162,228	\$170,381	1,841	1,941
Commercial	139,695	136,187	1,507	1,506
Industrial	58,232	60,049	1,014	1,048
Public street and highway lighting	3,607	3,473	13	13
Total retail	363,762	370,090	4,375	4,508
Wholesale	46,193	33,742	1,960	1,369
Sales of fuel	55,059	84,993	—	—
Other	10,889	9,403	—	—
Total	<u>\$475,903</u>	<u>\$498,228</u>	<u>6,335</u>	<u>5,877</u>

Retail electric revenues decreased \$6.3 million due to a decrease in total MWhs sold (decreased revenues \$11.0 million) primarily due to a decrease in use per customer as a result of warmer weather, and partially due to the continued weak economy and lower usage at certain industrial customers. This was partially offset by an increase in revenue per MWh (increased revenues \$4.7 million). Heating degree days at Spokane were close to historical average for the first half of 2012, but decreased 9 percent as compared to the first half of 2011. Compared to the six months ended June 30, 2011, residential electric use per customer decreased 6 percent. The increase in revenue per MWh was primarily due to the Washington and Idaho general rate increases.

Wholesale electric revenues increased \$12.5 million due to an increase in sales volumes (increased revenues \$13.9 million), partially offset by a decrease in sales prices (decreased revenues \$1.4 million). The increase in sales volumes was primarily due to increased wholesale power optimization and lower than expected retail sales.

When electric wholesale market prices are below the cost of operating our natural gas-fired thermal generating units, we sell the natural gas purchased for generation in the wholesale market rather than operate the generating units. The revenues from sales of fuel decreased \$29.9 million due to a decrease in sales of natural gas fuel as part of thermal generation resource optimization activities and higher usage of our thermal generation plants in the first half of 2012 as compared to the first half of 2011. This was due in part to decreased hydroelectric generation. For the six months ended June 30, 2012, \$18.9 million of these sales were made to our natural gas operations and are included as intracompany revenues and resource costs. For the six months ended June 30, 2011, \$12.9 million of these sales were made to our natural gas operations.

The net margin on wholesale sales and sales of fuel is applied to reduce or increase resource costs as accounted for under the ERM, the PCA mechanism, and in general rate cases as part of base power supply costs.

The following table presents our utility 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	
	2012	2011	2012	2011
Residential	\$118,283	\$127,785	112,366	121,790
Commercial	59,289	64,921	66,915	72,385
Interruptible	1,233	1,427	2,312	2,498
Industrial	2,090	2,343	2,835	3,050
Total retail	180,895	196,476	184,428	199,723
Wholesale	75,832	97,038	312,667	239,519
Transportation	3,568	3,441	80,261	80,122
Other	3,486	4,178	272	332
Total	<u>\$263,781</u>	<u>\$301,133</u>	<u>577,628</u>	<u>519,696</u>

Retail natural gas revenues decreased \$15.6 million primarily due to a decrease in volumes (decreased revenues \$15.0 million) and partially due to slightly lower retail rates (decreased revenues \$0.6 million). We sold less retail natural gas in the first half of 2012 as compared to the first half of 2011 primarily due to warmer weather. Compared to the first half of 2011, residential and commercial natural gas use per customer decreased 8 percent.

Wholesale natural gas revenues decreased \$21.2 million due to a decrease in prices (decreased revenues \$38.3 million), partially offset by an increase in volumes (increased revenues \$17.1 million). We plan for sufficient natural gas capacity to serve our retail customers on a theoretical peak day. As such, on nonpeak days we generally have more pipeline and storage capacity than what is needed. We engage in optimization of available interstate pipeline transportation and storage capacity through wholesale purchases and sales of natural gas to generate economic value

**AVISTA CORPORATION**

that offsets net natural gas costs. We hedge against expected natural gas volumes with forward purchases. In some situations, customer demand is below the amount hedged and we sell natural gas in excess of load requirements. In the first half of 2012, \$21.1 million of these sales were made to our electric generation operations and are included as intracompany revenues and resource costs. In the first half of 2011, \$27.9 million of these sales were made to our electric generation operations. Differences between revenues and costs from sales of resources in excess of retail load requirements and from resource optimization are accounted for through the PGA mechanisms.

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

	Electric Customers		Natural Gas Customers	
	2012	2011	2012	2011
Residential	318,345	316,551	286,547	284,666
Commercial	39,809	39,566	33,798	33,587
Interruptible	—	—	37	35
Industrial	1,394	1,370	261	251
Public street and highway lighting	475	453	—	—
Total retail customers	<u>360,023</u>	<u>357,940</u>	<u>320,643</u>	<u>318,539</u>

The following table presents our utility resource costs for the six months ended June 30 (dollars in thousands):

	2012	2011
<b>Electric resource costs:</b>		
Power purchased	\$ 89,866	\$ 83,797
Power cost amortizations, net	5,095	13,044
Fuel for generation	34,867	28,843
Other fuel costs	58,531	86,524
Other regulatory amortizations, net	9,171	7,686
Other electric resource costs	9,170	8,763
Total electric resource costs	<u>206,700</u>	<u>228,657</u>
<b>Natural gas resource costs:</b>		
Natural gas purchased	171,414	216,577
Natural gas cost amortizations, net	3,727	(8,895)
Other regulatory amortizations, net	5,172	8,349
Total natural gas resource costs	<u>180,313</u>	<u>216,031</u>
Intracompany resource costs	(40,009)	(40,791)
Total resource costs	<u>\$347,004</u>	<u>\$403,897</u>

Power purchased increased \$6.1 million due to an increase in the volume of power purchases (increased costs \$11.8 million), partially offset by a decrease in wholesale prices (decreased costs \$5.7 million).

Net amortization of deferred power costs was \$5.1 million for the six months ended June 30, 2012 compared to \$13.0 million for the six months ended June 30, 2011. During the six months ended June 30, 2012, we recovered (collected as revenue) \$1.2 million of previously deferred power costs in Idaho through the PCA surcharge. The Washington ERM surcharge was eliminated in February 2010, since the previous balance of deferred power costs had been recovered. During the six months ended June 30, 2012, actual power supply costs were below the amount included in base retail rates and we deferred \$3.5 million in Washington and \$0.4 million in Idaho for potential future rebate to customers.

Fuel for generation increased \$6.0 million primarily due to an increase in thermal generation. This was due in part to a decrease in hydroelectric generation. The increase in thermal generation usage was partially offset by a decrease in natural gas fuel prices.

Other fuel costs decreased \$28.0 million. This represents fuel that was purchased for generation but was later sold when conditions indicated that it was not economical to use the fuel for generation, as part of the resource optimization process. The associated revenues are reflected as sales of fuel.

The expense for natural gas purchased decreased \$45.1 million due to a decrease in the price of natural gas (decreased costs \$57.2 million), partially offset by an increase in total therms purchased (increased costs \$12.1 million). Total therms purchased increased due to an increase in wholesale sales with the balancing of loads and resources as part of the natural gas procurement and resource optimization process. We engage in optimization of available interstate pipeline transportation and storage capacity through wholesale purchases and sales of natural gas to generate economic value that offsets net natural gas costs.

**AVISTA CORPORATION**

---

**Ecova**

***Three months ended June 30, 2012 compared to the three months ended June 30, 2011***

Ecova's net income attributable to Avista Corp. was \$1.1 million for the three months ended June 30, 2012 compared to net income of \$1.8 million for the three months ended June 30, 2011. Operating revenues increased \$10.3 million and total operating expenses increased \$12.0 million. The increase in operating revenues was primarily due to the acquisitions of Prenova effective November 30, 2011 and LPB effective January 31, 2012, which added \$6.4 million to operating revenues for the second quarter of 2012. The increase in total operating expenses primarily reflects increased costs necessary to support ongoing and future business growth, as well as to support the increased revenue volume obtained through the acquisitions. Ecova experienced increases in employee costs, facilities costs, information technology costs and professional fees. Depreciation and amortization increased \$1.7 million due to intangibles recorded in connection with the acquisitions. As of June 30, 2012, Ecova had 736 expense management customers representing 602,000 billed sites in North America. In the second quarter of 2012, Ecova managed bills totaling \$4.6 billion, a decrease of \$0.1 billion as compared to the second quarter of 2011. This decrease was due to a decrease in the average value of each bill (due in part to a decline in natural gas prices), partially offset by an increase in accounts managed.

***Six months ended June 30, 2012 compared to the six months ended June 30, 2011***

Ecova's net income attributable to Avista Corp. was \$0.3 million for the six months ended June 30, 2012 compared to net income of \$3.5 million for the six months ended June 30, 2011. Operating revenues increased \$18.1 million and total operating expenses increased \$25.0 million. The increase in operating revenues was primarily due to the acquisitions of Prenova effective November 30, 2011 and LPB effective January 31, 2012, which added \$11.6 million to operating revenues for the six months ended June 30, 2012. The increase in total operating expenses primarily reflects increased costs necessary to support ongoing and future business growth, as well as to support the increased revenue volume obtained through the acquisitions. Ecova experienced increases in employee costs, facilities costs, information technology costs and professional fees. In addition, Ecova incurred \$1.5 million in transaction and integration costs, and \$0.3 million paid for the early termination of an earn-out contract. Depreciation and amortization increased \$2.9 million due to intangibles recorded in connection with the acquisitions. In the first half of 2012, Ecova managed bills totaling \$9.0 billion, a decrease of \$0.5 billion as compared to the first half of 2011. This decrease was due to a decrease in the average value of each bill (due in part to a decline in natural gas prices), partially offset by an increase in accounts managed.

**Other Businesses**

***Three months ended June 30, 2012 compared to the three months ended June 30, 2011***

The net loss from these operations was \$1.0 million for the three months ended June 30, 2012 compared to net income of \$0.1 million for the three months ended June 30, 2011. The decline in results was primarily due to increased litigation costs for the remaining contracts and previous operations of Avista Energy. METALfx had net income of \$0.5 million for each of the second quarters of 2012 and 2011. Losses on investments were \$0.1 million for each of the second quarters of 2012 and 2011.

***Six months ended June 30, 2012 compared to the six months ended June 30, 2011***

The net loss from these operations was \$1.3 million for the six months ended June 30, 2012 compared to net income of \$0.2 million for the six months ended June 30, 2011. The decline in results was primarily due to increased litigation costs for the remaining contracts and previous operations of Avista Energy, as well as a net loss on investments. METALfx had net income of \$0.8 million for each of the six months ended June 30, 2012 and 2011. Losses on investments were \$0.5 million for the six months ended June 30, 2012 and less than \$0.1 million for the six months ended June 30, 2011.

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect amounts reported in the consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on our consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. Our critical accounting policies that require the use of estimates and assumptions were discussed in detail in the 2011 Form 10-K and have not changed materially from that discussion.

**AVISTA CORPORATION**

---

**Liquidity and Capital Resources**

**Review of Condensed Consolidated Cash Flow Statement**

**Overall** During the six months ended June 30, 2012, positive cash flows from operating activities of \$199.7 million, \$30.0 million of borrowings under Avista Corp.'s \$400.0 million committed line of credit and \$25.0 million of borrowings under Ecova's committed line of credit were used to fund the majority of our cash requirements. These cash requirements included utility capital expenditures of \$120.5 million, cash paid for the acquisition of LPB of \$50.3 million and dividends of \$34.1 million.

**Operating Activities** Net cash provided by operating activities was \$199.7 million for the six months ended June 30, 2012 compared to \$163.5 million for the six months ended June 30, 2011. Net cash provided by working capital components was \$61.9 million for the six months ended June 30, 2012, compared to \$26.8 million for the six months ended June 30, 2011. The net cash provided during the six months ended June 30, 2012 primarily reflects net cash inflows related to accounts receivable and positive cash flows from other current assets (primarily related to a decrease in income taxes receivable).

The net cash provided during the six months ended June 30, 2011 primarily reflects positive cash flows from accounts receivable (representing a seasonal decrease in receivables outstanding). These positive cash flows were partially offset by net cash outflows related to accounts payable.

Contributions to our defined benefit pension plan were \$29.4 million for the first half of 2012 compared to \$17.3 million for the first half of 2011. Cash paid for interest was \$36.3 million for the first half of 2012, compared to \$34.5 million for the first half of 2011.

**Investing Activities** Net cash used in investing activities was \$182.5 million for the six months ended June 30, 2012, compared to \$64.0 million for the six months ended June 30, 2011. Utility property capital expenditures increased by \$21.6 million for the first half of 2012 as compared to the first half of 2011. In the first half of 2012, a significant portion of Ecova's funds held for clients were held as securities available for sale (purchases of \$64.9 million and sales and maturities of \$71.5 million). In the first half of 2011, the funds held for clients were in cash and cash equivalents, as well as money market funds. The net cash paid by subsidiaries for acquisitions for the six months ended June 30, 2012 of \$50.3 million represents Ecova's acquisition of LPB.

**Financing Activities** Net cash provided by financing activities was \$1.5 million for the six months ended June 30, 2012 compared to net cash used of \$99.0 million for the six months ended June 30, 2011. During the first half of 2012, short-term borrowings on Avista Corp.'s committed line of credit increased \$30.0 million. Borrowings on Ecova's committed line of credit increased \$25.0 million and these proceeds were used to fund the acquisition of LPB. Cash dividends paid increased to \$34.1 million (or 58 cents per share) for the first half of 2012 from \$31.7 million (or 55 cents per share) for the first half of 2011. In May 2012, we cash settled interest rate swap agreements for \$18.5 million related to the pricing of \$80.0 million of long-term debt (the issuance will occur in November 2012). Client fund obligations at Ecova increased \$9.8 million.

During the six months ended June 30, 2011, our short-term borrowings decreased \$35.0 million. We issued \$15.9 million of common stock during the six months ended June 30, 2011, including \$12.1 million under a sales agency agreement. Additionally, client fund obligations at Ecova decreased by \$33.4 million.

**Overall Liquidity**

Our consolidated operating cash flows are primarily derived from the operations of Avista Utilities. The primary source of operating cash flows for our utility operations is revenues from sales of electricity and natural gas. Significant uses of cash flows from our utility operations include the purchase of power, fuel and natural gas, and payment of other operating expenses, taxes and interest, with any excess being available for other corporate uses such as capital expenditures and dividends.

We design operating and capital budgets to control operating costs and to direct capital expenditures to choices that support immediate and long-term strategies, particularly for our regulated utility operations. In addition to operating expenses, we have continuing commitments for capital expenditures for construction, improvement and maintenance of utility facilities.

Over time, our operating cash flows usually do not fully support the amount required for utility capital expenditures. As such, from time to time, we need to access long-term capital markets in order to fund these needs as well as fund maturing debt. See further discussion at "Capital Resources."

We periodically file for rate adjustments for recovery of operating costs and capital investments to provide the opportunity to improve our earned returns as allowed by regulators. See further details in the section "Avista Utilities - Regulatory Matters."

**AVISTA CORPORATION**

---

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

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

We monitor the potential liquidity impacts of increasing energy commodity prices and other increased operating costs for our utility operations. We believe that we have adequate liquidity to meet the increased cash needs of potentially higher energy commodity prices and increased other operating costs through our \$400.0 million committed line of credit.

As of June 30, 2012, we had \$283.9 million of available liquidity under our committed line of credit. With our \$400.0 million credit facility that expires in February 2017, we believe that we have adequate liquidity to meet our needs for the next 12 months.

Our utility has regulatory mechanisms in place that provide for the deferral and recovery of the majority of power and natural gas supply costs. However, if prices rise above the level currently allowed in retail rates in periods when we are buying energy, deferral balances would increase, negatively affecting our cash flow and liquidity until such time as these costs, with interest, are recovered from customers.

**Credit and Nonperformance Risk**

Our contracts for the purchase and sale of energy commodities can require collateral in the form of cash or letters of credit. As of June 30, 2012, we had cash deposited as collateral of \$19.0 million and letters of credit of \$17.5 million outstanding related to our energy derivative contracts. Price movements and/or a downgrade in our credit ratings could impact further the amount of collateral required. See “Credit Ratings” for further information. For example, in addition to limiting our ability to conduct transactions, if our credit ratings were lowered to below “investment grade” based on our positions outstanding at June 30, 2012, we would potentially be required to post additional collateral of up to \$23.8 million. This amount is different from the amount disclosed in “Note 5 of the Notes to Condensed Consolidated Financial Statements” because, while this analysis includes contracts that are not considered derivatives in addition to the contracts considered in Note 5, this analysis takes into account contractual threshold limits that are not considered in Note 5. Without contractual threshold limits, we would potentially be required to post additional collateral of \$62.4 million.

Under the terms of interest rate swap agreements that we enter into periodically, we may be required to post cash or letters of credit as collateral depending on fluctuations in the fair value of the instrument. This has not historically been significant to our liquidity position. As of June 30, 2012, we had interest rate swap agreements outstanding with a notional amount totaling \$160 million and we did not have any collateral posted. If our credit ratings were lowered to below “investment grade” based on our interest rate swap agreements outstanding at June 30, 2012, we would potentially be required to post additional collateral of up to \$0.9 million.

**Dodd-Frank Wall Street Reform and Consumer Protection Act**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was enacted into law in July 2010. The Dodd-Frank Act establishes regulatory jurisdiction by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) for certain swaps (which include a variety of derivative instruments) and certain users of such swaps, that previously had been largely exempted from regulation.

A variety of rules must be adopted by federal agencies (including the CFTC, SEC and the FERC) to implement the Dodd-Frank Act. These rules being developed and implemented will clarify the impact of the Dodd-Frank Act on Avista Corp., which may be significant.

Under the Dodd-Frank Act, “Swap Dealers” and “Major Swap Participants” generally will be required to collect minimum initial and variation margin from their counterparties for non-cleared swaps. However, the requirement varies with the type of counterparty and the regulator of the “Major Swap Participant” or “Swap Dealer.” Avista Corp. should be categorized as a counterparty that is a non-financial end user for the purposes of the Dodd-Frank Act, i.e., as a non-financial entity that engages in derivatives to hedge commercial risk. In April 2012, the SEC and the CFTC issued a joint final rule with respect to security-based swap dealers or security-based major swap participants. Based on the proposed definitions and the de minimis rule, we believe that Avista Corp. is unlikely to be classified as a security-based swap dealer or security-based major swap participant.

**AVISTA CORPORATION**

The Dodd-Frank Act also requires certain swaps to be cleared and traded on exchanges or swap execution facilities. Such clearing requirements would result in a significant change from our current practice of bilaterally negotiated credit terms. An exemption from mandatory clearing is available under the Dodd-Frank Act for counterparties that are non-financial end users using swaps to hedge commercial risk. However, the cost of entering into a non-cleared swap that is available as a cleared swap may be greater and margin levels are expected to be higher.

In July 2012, the CFTC issued a final rule providing for an exemption from clearing requirements as outlined in Dodd-Frank for end users that enter into hedges to mitigate commercial risk. We expect to qualify under the end user exemption.

We will continue to monitor developments regarding implementation steps defined in the Act. We cannot predict the impact the Dodd-Frank Act may ultimately have on our operations.

**Capital Resources**

Our consolidated capital structure, including the current portion of long-term debt and short-term borrowings, and excluding noncontrolling interests, consisted of the following as of June 30, 2012 and December 31, 2011 (dollars in thousands):

	June 30, 2012		December 31, 2011	
	Amount	Percent of total	Amount	Percent of total
Current portion of long-term debt	\$ 423	— %	\$ 7,474	0.3%
Current portion of nonrecourse long-term debt	14,304	0.5	13,668	0.5
Short-term borrowings	91,000	3.5	96,000	3.8
Long-term borrowings under committed line of credit	60,000	2.3	—	—
Long-term debt to affiliated trusts	51,547	2.0	51,547	2.0
Nonrecourse long-term debt	25,474	1.0	32,803	1.3
Long-term debt	1,147,765	44.0	1,169,826	45.7
Total debt	1,390,513	53.3	1,371,318	53.6
Total Avista Corporation stockholders' equity	1,216,842	46.7	1,185,701	46.4
Total	<u>\$2,607,355</u>	<u>100.0%</u>	<u>\$2,557,019</u>	<u>100.0%</u>

We need to finance capital expenditures and acquire additional funds for operations from time to time. The cash requirements needed to service our indebtedness, both short-term and long-term, reduces the amount of cash flow available to fund capital expenditures, purchased power, fuel and natural gas costs, dividends and other requirements. Our stockholders' equity increased \$31.1 million during the six months ended June 30, 2012 primarily due to net income, partially offset by dividends.

We generally fund capital expenditures with a combination of internally generated cash and external financing. The level of cash generated internally and the amount that is available for capital expenditures fluctuates depending on a variety of factors. Cash provided by our utility operating activities, as well as issuances of long-term debt and common stock, are expected to be the primary source of funds for operating needs, dividends and capital expenditures for 2012. Borrowings under our \$400.0 million committed line of credit will supplement these funds to the extent necessary.

In June 2012, we entered into a bond purchase agreement with certain institutional investors in the private placement market for the purpose of issuing \$80.0 million of 4.23 percent First Mortgage Bonds due in 2047. The issuance of the bonds will occur at closing in November 2012. The total net proceeds from the sale of the new bonds will be used to repay a portion of the borrowings outstanding under our \$400.0 million committed line of credit and for general corporate purposes. In connection with the pricing of the First Mortgage Bonds, we cash settled interest rate swap contracts and paid a total of \$18.5 million, which will be amortized as a component of interest expense over the life of the debt.

We are planning to issue up to \$45 million of common stock from time to time in 2012 (with the majority in the second half of the year) in order to maintain our capital structure at an appropriate level for our business. The additional shares are expected to be issued under a periodic offering program, as well as the dividend reinvestment and direct stock purchase plan and employee plans.

We have a committed line of credit with various financial institutions in the total amount of \$400.0 million with an expiration date of February 2017.

Our committed line of credit agreement contains customary covenants and default provisions, including a covenant which does not permit our ratio of "consolidated total debt" to "consolidated total capitalization" to be greater than 65 percent at any time. As of June 30, 2012, we were in compliance with this covenant with a ratio of 53.3 percent.

## [Table of Contents](#)

### **AVISTA CORPORATION**

Balances outstanding and interest rates of borrowings (excluding letters of credit) under our committed line of credit were as follows as of and for the six months ended June 30 (dollars in thousands):

	2012	2011
Balance outstanding at end of period	\$91,000	\$ 75,000
Letters of credit outstanding at end of period	\$25,075	\$ 19,023
Maximum balance outstanding during the period	\$91,000	\$110,000
Average balance outstanding during the period	\$14,434	\$ 71,191
Average interest rate during the period	1.24%	1.32%
Average interest rate at end of period	1.20%	1.48%

The decrease in the average balance outstanding was due in part to a new intercompany borrowing arrangement between Avista Corp. and Ecova. As part of their cash management practices and operations, Ecova and Avista Corp. entered into an arrangement in January 2012 under which (1) Avista Corp. issued to Ecova a master unsecured promissory note and (2) Ecova will from time to time make short-term loans to Avista Corp. as a temporary investment of its funds received from its clients. The master promissory note limits the total outstanding indebtedness to no more than \$50.0 million in principal. Additionally, such loans are required to be repaid on the last business day of each quarter (March, June, September and December) and sooner upon demand by Ecova. Amounts are loaned at a rate consistent with Avista Corp.'s credit facility. The average balance outstanding was \$32.1 million and the maximum balance was \$50.0 million during the six months ended June 30, 2012.

Any default on the line of credit or other financing arrangements of Avista Corp. or any of our "significant subsidiaries", if any, could result in cross-defaults to other agreements of such entity, and/or to the line of credit or other financing arrangements of any other of such entities. Any defaults could also induce vendors and other counterparties to demand collateral. In the event of any such default, it would be difficult for us to obtain financing on reasonable terms to pay creditors or fund operations. We would also likely be prohibited from paying dividends on our common stock. Avista Corp. does not guarantee the indebtedness of any of its subsidiaries. As of June 30, 2012, Avista Corp. and its subsidiaries were in compliance with all of the covenants of their financing agreements, and none of Avista Corp.'s subsidiaries constituted a "significant subsidiary" as defined in Avista Corp.'s committed line of credit.

#### **Avista Utilities Capital Expenditures**

We expect utility capital expenditures to be about \$250 million for each of 2012, 2013 and 2014. These estimates of capital expenditures are subject to continuing review and adjustment. Actual capital expenditures may vary from our estimates due to factors such as changes in business conditions, construction schedules and environmental requirements. Future generation resource decisions may be further impacted by legislation for restrictions on greenhouse gas (GHG) emissions and renewable energy requirements as discussed at "Environmental Issues and Other Contingencies."

Included in our estimates of capital expenditures is the replacement of our customer information and work management systems, which is expected to be completed by the end of 2014.

#### **Ecova Credit Agreement**

As of June 30, 2012, Ecova had a \$60.0 million committed line of credit agreement with a financial institution that was scheduled to expire in April 2014. In July 2012, Ecova entered into a new five-year \$125.0 million committed line of credit agreement with various financial institutions that replaced its \$60.0 million committed line of credit agreement. The credit agreement is secured by substantially all of Ecova's assets. There were \$60.0 million of borrowings outstanding under Ecova's credit agreement as of June 30, 2012 classified as long-term. The proceeds from these borrowings were used to fund the acquisitions of Prenova in November 2011 and LPB in January 2012.

#### **Ecova Redeemable Stock**

In 2007, Ecova amended its employee stock incentive plan to provide an annual window at which time holders of common stock can put their shares back to Ecova providing the shares are held for a minimum of six months. Stock is reacquired at estimated fair value at the date of reacquisition. As the repurchase feature is at the discretion of the minority shareholders and option holders, there were redeemable noncontrolling interests of \$11.8 million as of June 30, 2012 for the intrinsic value of stock options outstanding, as well as outstanding redeemable stock. In 2009, the Ecova employee stock incentive plan was amended such that, on a prospective basis, not all options granted under the plan have the put right. Additionally, there were redeemable noncontrolling interests of \$41.6 million related to the 2008 Cadence Network acquisition, as the previous owners could have exercised a right to put their stock back to Ecova in July 2011 or July 2012 if their investment in Ecova was not liquidated through either an initial public offering or sale of the business to a third party. These redemption rights were not exercised and expired effective July 31, 2012.

**AVISTA CORPORATION****Off-Balance Sheet Arrangements**

As of June 30, 2012, we had \$25.1 million in letters of credit outstanding under our \$400.0 million committed line of credit, a decrease from \$29.0 million as of December 31, 2011.

**Pension Plan**

As of June 30, 2012, our pension plan had assets with a fair value that was less than the benefit obligation under the plan. We contributed \$26 million to the pension plan in 2011. We expect to contribute a total of \$176 million (or \$44 million per year) to the pension plan in the period 2012 through 2015. In the first half of 2012, we contributed \$29.4 million to the pension plan. The final determination of pension plan contributions for future periods is subject to multiple variables, most of which are beyond our control, including further changes to the fair value of pension plan assets and changes in actuarial assumptions (in particular the discount rate used in determining the benefit obligation).

The “Moving Ahead for Progress in the 21st Century” (MAP-21) was signed into federal law in July 2012. This law contains provisions that permit sponsors of single-employer defined benefit plans to use stabilized interest rate assumptions for certain funding calculations, thus decreasing required employer contributions and improving plan-funding attainment percentages. MAP-21 also increases Pension Benefit Guaranty Corporation (PBGC) premiums effective in 2013. We do not expect MAP-21 to have a significant impact on our pension contributions or PBGC premiums from 2012 through 2015.

**Credit Ratings**

Our access to capital markets and our cost of capital are directly affected by our credit ratings. In addition, many of our contracts for the purchase and sale of energy commodities contain terms dependent upon our credit ratings. See “Credit and Nonperformance Risk” and “Note 5 of the Notes to Condensed Consolidated Financial Statements.” The following table summarizes our credit ratings as of August 7, 2012:

	<u>Standard &amp; Poor's (1)</u>	<u>Moody's (2)</u>
Corporate/Issuer rating	BBB	Baa2
Senior secured debt	A-	A3
Senior unsecured debt	BBB	Baa2

(1) Standard & Poor's lowest level of “investment grade” credit rating is BBB-.

(2) Moody's lowest level of “investment grade” credit rating is Baa3.

A security rating is not a recommendation to buy, sell or hold securities. Each security rating is subject to revision or withdrawal at any time by the assigning rating organization. Each security rating agency has its own methodology for assigning ratings, and, accordingly, each rating should be considered in the context of the applicable methodology, independent of all other ratings. The rating agencies provide ratings at the request of Avista Corporation and charge fees for their services.

**Dividends**

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

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

Our net income available for dividends is primarily derived from our regulated utility operations. The payment of dividends on common stock is restricted by provisions of certain covenants applicable to preferred stock (when outstanding) contained in our Restated Articles of Incorporation, as amended.

In May 2012, Avista Corp.'s Board of Directors declared a quarterly dividend of \$0.29 per share on the Company's common stock. In August 2012, Avista Corp.'s Board of Directors declared a quarterly dividend of \$0.29 per share on the Company's common stock.

**Contractual Obligations**

Our future contractual obligations have not changed materially from the amounts disclosed in the 2011 Form 10-K, with the following exceptions:

As of June 30, 2012, we had \$91.0 million of borrowings outstanding under our committed line of credit. There were \$61.0 million in borrowings outstanding as of December 31, 2011.

As of June 30, 2012, Ecova had \$60.0 million of borrowings outstanding under its committed line of credit. There were \$35.0 million in borrowings outstanding as of December 31, 2011.

**AVISTA CORPORATION**

---

In connection with the replacement of our customer information and work management systems, we have entered into various contracts with vendors in the total amount of \$21 million through 2014.

**Economic Conditions**

The general economic data, on both national and local levels, contained in this section is based, in part, on independent government and industry publications, reports by market research firms or other independent sources. While we believe that these publications and other sources are reliable, we have not independently verified such data and can make no representation as to its accuracy.

We continue to experience customer growth as the regional economy recovers from the recession. We have three distinct metropolitan areas in our service area: Spokane, Washington, Coeur d'Alene, Idaho and Medford, Oregon; and we are tracking three separate economic indicators: employment change, unemployment rates and foreclosure rates. We have observed mixed results during the economic recovery. On a year-over-year basis, June 2012 employment growth rates are positive except for Spokane, and unemployment rates are lower in all three areas. Foreclosure rates are below the U.S. rate in the Spokane and Coeur d'Alene areas. Compared to the U.S. economy, the recovery in our service area has been slower. In 2012, we continue to expect overall economic growth in our service area to be somewhat lower than U.S. growth.

Seasonally adjusted nonfarm employment in our northern Idaho and southwestern Oregon service areas exhibited moderate growth between June 2011 and June 2012. For the same period, growth in eastern Washington has yet to show signs of recovery. Employment increased by 3.4 percent in Coeur d'Alene, Idaho, reflecting gains in most sectors, with considerable strength in professional and business services; trade, transport, and utilities; and education and health services. In Medford, Oregon, employment growth was 2.2 percent, also with broadly distributed sector gains, with particular strength in manufacturing and leisure and hospitality. However, the government sector continues to be a drag on overall employment growth in the Medford area. We observed an employment decline of 0.4 percent in the Spokane area with gains in manufacturing and business and professional services offset by sector losses in education, health services and government. U.S. nonfarm sector jobs grew by 1.4 percent in the same twelve-month period.

The unemployment rate went down in June 2012 from the year earlier level in Spokane, Medford, and Coeur d'Alene. In Spokane the rate was 9.2 percent in June 2011 and declined to 8.8 percent in June 2012. In Medford the rate declined from 12.0 percent to 10.7 percent while in Coeur d'Alene the rate went from 9.5 percent to 8.0 percent. The U.S. rate declined from 9.1 percent to 8.2 percent in the same period.

The housing market in our service area continues to experience foreclosure rates comparable to or lower than the national average. The June 2012 national rate was 0.15 percent with a near national average level at 0.16 percent in Jackson County, Oregon. The Spokane housing market was 0.09 percent and Kootenai County, Idaho was 0.05 percent.

**Environmental Issues and Other Contingencies**

We are subject to environmental regulation by federal, state and local authorities. The generation, transmission, distribution, service and storage facilities in which we have ownership interests are designed and operated in compliance with applicable environmental laws. Furthermore, we conduct periodic reviews and audits of pertinent facilities and operations to ensure compliance and to respond to or anticipate emerging environmental issues. The Company's Board of Directors has a committee to oversee environmental issues.

We monitor legislative and regulatory developments at all levels of government for environmental issues, particularly those with the potential to impact the operation and productivity of our generating plants and other assets.

Environmental laws and regulations may:

- increase the operating costs of generating plants,
- increase the lead time and capital costs for the construction of new generating plants,
- require modification of our existing generating plants,
- require existing generating plant operations to be curtailed or shut down,
- reduce the amount of energy available from our generating plants,
- restrict the types of generating plants that can be built or contracted with, and
- require construction of specific types of generation plants at higher cost.

Compliance with environmental laws and regulations could result in increases to capital expenditures and operating expenses. We intend to seek recovery of any such costs through the ratemaking process.

### ***Climate Change and Greenhouse Gas Emission Reduction Initiatives***

Concerns about long-term global climate changes could have a significant effect on our business. Our operations could also be affected by changes in laws and regulations intended to mitigate the risk of or alter global climate changes, including restrictions on the operation of our power generation resources and obligations imposed on the sale of natural gas. Changing temperatures and precipitation, including snowpack conditions, affect the availability and timing of streamflows, which impact hydroelectric generation. Extreme weather events could increase service interruptions, outages and maintenance costs. Changing temperatures could also increase or decrease customer demand.

Greenhouse gas (GHG) emission standards could result in significant compliance costs. Such standards could also preclude us from developing, operating or contracting with certain types of generating plants.

We continue to monitor and evaluate the possible adoption of international, national, regional, or state GHG emission legislation and regulations. As the U.S. Congress has not enacted any comprehensive climate change legislation, for the foreseeable future climate change regulations are expected to emerge from the EPA and from individual states. In particular, climate change legislation was passed in the state of Washington, which includes a bill establishing GHG emissions reduction targets and another requiring that regulated sources report GHG emission from facilities that emit more than 10,000 metric tons of GHGs per year.

Although we are actively monitoring developments for climate change policies and restrictions on GHG emissions, it is important to note that we have relatively low GHG emissions as compared to other investor-owned utilities in the U.S. With 60 percent of our electric generation resource mix derived from renewable sources (including hydroelectric, biomass and contracts with wind generation projects) and a majority of our thermal generation fueled with natural gas, plus a commitment to energy efficiency, we are among the lowest carbon-emitting utilities in the nation.

Our Climate Policy Council (an interdisciplinary team of management and other employees) works to:

- facilitate internal and external communications regarding climate change issues,
- analyze policy impacts, anticipate opportunities and evaluate strategies for Avista Corp., and
- develop recommendations on climate related policy positions and action plans.

### ***National Legislation***

Climate change legislation has been proposed in the U.S. Congress; however, recent actions in the U.S. Congress indicate that climate change legislation is unlikely at this time. We continue to monitor the situation for new developments that could affect our business.

### ***Recent EPA Initiatives Related to Climate Change***

After a public comment and review period, in December 2009, the EPA issued an “endangerment finding” regarding GHG emissions from motor vehicles under section 202(a) of the Clean Air Act (CAA). Specifically, the EPA found that the combined emissions of GHG from new motor vehicles and new motor vehicle engines contribute to the GHG pollution which threatens public health and welfare. On April 1, 2010, the EPA and the Department of Transportation’s National Highway Safety Administration announced a joint final rule establishing GHG emission standards for mobile sources. The GHG emission standards for mobile sources became effective on January 2, 2011. The EPA has concluded that the CAA requires the agency to regulate GHG emissions from stationary sources through its preconstruction and operating permit programs on the date when EPA regulations require any source (mobile or stationary) to meet GHG emission limits. In May 2010, the EPA finalized a rule establishing an applicability threshold for regulating GHG emissions from stationary sources through the preconstruction and operating permit programs.

The EPA issued a series of rules on December 23, 2010 to narrow the CAA permitting requirement so that facilities with GHG emissions below the levels set in the tailoring rule do not need permits, as well as to give the EPA authority to issue GHG permits in states that need to revise their permitting regulations to cover GHG emissions. On January 2, 2011, rules took effect requiring that permits issued under the CAA for new large stationary sources begin to address GHG emissions, as well as require Best Available Control Technology (BACT) to control these emissions. On July 20, 2011, the EPA finalized a rule that defers, for a period of three years, the GHG permitting requirements for carbon dioxide for utilities, boilers and other industrial facilities using biomass. The EPA’s final decision to regulate GHG emissions from stationary sources and to establish applicability thresholds for GHGs has been challenged in the U.S. Court of Appeals for the District of Columbia.

The EPA is planning to issue regulations controlling GHG emissions from electric generating units. According to a previously announced schedule, the EPA was to propose standards for natural gas, oil and coal-fired electric generating units by September 30, 2011, and issue final standards by May 26, 2012. The EPA recently announced that it would not meet this schedule and has not yet provided a new schedule. The EPA had agreed to the original schedule as part of a settlement, as modified, with several states, local governments and environmental organizations

**AVISTA CORPORATION**

---

that sued the EPA over its failure to update emissions standards for power plants and refineries as required by Section 111 of the CAA. Section 111 requires the EPA to issue New Source Performance Standards that set emissions limits for new facilities and, under certain circumstances, address emissions from existing facilities. These rules could significantly impact the costs of modifying existing thermal plants as well as building new thermal generation sources. We cannot determine or estimate the costs of compliance with such measures at this time.

In September 2009, the EPA finalized the Mandatory Reporting Rule (MRR) that requires facilities emitting over 25,000 metric tons of GHG a year to report their emissions to the EPA beginning in January 2011 for 2010 emissions. On March 18, 2011, the EPA issued a rule extending the deadline for reporting 2010 GHG emissions data to September 30, 2011. Based on rule applicability criteria, Colstrip, Coyote Springs 2, and the Rathdrum CT recently reported GHGs to the EPA. The rule also required that natural gas distribution system throughput be reported along with the development of a GHG Monitoring Plan. On March 22, 2010, the EPA proposed to further amend its reporting rule to include several new source categories, including reporting of GHG fugitive emissions from electric power transmission and distribution systems, fugitive emissions from natural gas distribution systems, and fugitive emissions from natural gas storage facilities. Reporting for these additional sources for 2011 emissions was required by March 31, 2012.

On March 27, 2012, the EPA proposed a Carbon Pollution Standard for new power plants. The EPA proposed that new fossil-fuel-fired power plants meet an output-based standard of 1,000 pounds of carbon dioxide per megawatt-hour. New power plants that are designed to use coal or petroleum coke would be able to incorporate technology to reduce carbon dioxide emissions to meet the standard, such as carbon capture and storage. For purposes of this rule, fossil-fuel-fired generation units include fossil-fuel-fired boilers, integrated gasification combined cycle units and stationary combined cycle turbine units that generate electricity for sale and are larger than 25 MW; simple cycle turbine units are exempt. The proposal would not apply to existing units including modifications such as changes needed to meet other air pollution standards and new power plant units that have permits and start construction within 12 months of this proposal. We are unable to determine if or to what extent the proposed standard, if adopted, would have on our thermal generating facilities at this time.

**State Activities**

The states of Washington and Oregon have statutory targets to reduce GHG emissions. Washington's targets are intended to reduce GHG emissions to 1990 levels by 2020; to 25 percent below 1990 levels by 2035; and to 50 percent below 1990 levels by 2050. Oregon's targets would reduce GHG emissions to 10 percent below 1990 levels by 2020 and 75 percent below 1990 levels by 2050. Both states enacted their targets expecting that they would be met through a combination of renewable energy standards, and assorted "complementary policies," such as land-use policies, energy efficiency codes for buildings, renewable fuel standards and vehicle emission standards. However, neither state has yet adopted any comprehensive requirements aimed specifically at achieving these targets.

Washington State's Department of Ecology has adopted regulations to ensure that its State Implementation Plan comports with the requirements of the EPA's regulation of GHG emissions. We will continue to monitor actions by the Department as it may proceed to adopt additional regulations under its CAA authorities. Late in 2011, a Federal District Court ruled that the Department of Ecology must require six refineries located in the state to install reasonably available control technology (RACT) to control and reduce their greenhouse gas emissions. This decision turned, on the meaning of "air contaminate" under Washington law, the United States Supreme Court decision in *Massachusetts v. EPA* (549 U.S. 497 (2007)), and administrative actions were taken by the EPA. The Court's decision could have implications for other industrial emitters of greenhouse gases in the state of Washington, in part because the decision will require the Department of Ecology to determine what measures might constitute RACT. If and how the decision might impact other industries will not be clear until the decision is finalized and any challenges to it have been exhausted.

Washington and Oregon apply a GHG emissions performance standard to electric generation facilities used to serve retail loads in their jurisdictions. The emissions performance standard prevents utilities from constructing or purchasing generation facilities, or entering into power purchase agreements of five years or longer duration to purchase energy produced by plants that have emission levels higher than 1,100 pounds of GHG per MWh. The Department of Commerce has commenced a process that is expected to result in the adoption of a lower emissions performance standard this year (2012); a new standard will be applicable until at least 2017.

Initiative Measure 937 (I-937), the Energy Independence Act, was passed into law through the 2006 General Election in Washington. I-937 requires investor-owned, cooperative, and government-owned electric utilities with over 25,000 customers to acquire qualified renewable energy resources and/or renewable energy credits in incremental amounts until those resources or credits equal 15 percent of the utility's total retail load in 2020. I-937 also requires these utilities to meet biennial energy conservation targets, the first of which must be met in 2012. Furthermore, by January 1, 2012, electric utilities subject to I-937's mandates were required to acquire enough qualified incremental renewable energy and/or renewable energy credits to meet 3 percent of their load. This renewable energy standard increases to 9

**AVISTA CORPORATION**

---

percent in 2016. Failure to comply with renewable energy and energy efficiency standards could result in penalties of \$50 per MWh or greater being assessed against a utility for each MWh it is deficient in meeting a standard. A utility would be deemed to comply with the renewable energy standard if it invests at least 4 percent of its total annual retail revenue requirement on the incremental costs of renewable energy resources and/or renewable energy credits. As noted in the following section, we have taken the steps necessary to meet the requirements of I-937. In 2012, the Governor signed into law Senate Bill 5575, which amended I-937 to define our Kettle Falls Generating Station and certain other biomass energy facilities which commenced operation before March 31, 1999, as resources that may be used to meet the renewable energy standards beginning in 2016.

***Wind Power Purchase Agreement***

In June 2011, we entered into a 30-year power purchase agreement (PPA) with Palouse Wind, LLC (Palouse Wind), an affiliate of First Wind Holdings, LLC. Under the PPA, we will acquire all of the power and renewable attributes produced by a wind project being developed by Palouse Wind in Whitman County, Washington. The wind project, which is currently under construction, is expected to have a nameplate capacity of approximately 105 MW and produce approximately 40 aMW with deliveries beginning by the end of 2012. We decided to enter into this PPA due, in part, to market changes reducing the cost of renewable resource projects. This was due, in part, to tax incentives for the construction of renewable resource projects that remain in effect through 2012. We acquired the development rights for a separate wind generation site near Reardan, Washington in 2008 and continue to study that site in preparation for later development. We plan to meet the state of Washington's renewable energy standards until 2016 with a combination of qualified upgrades at our existing hydroelectric generation plants. The power purchased from Palouse Wind will help to meet our Washington renewable energy requirements beginning in 2016, as well as provide a new energy resource to serve our system retail load requirements. Under the PPA, we have the option to purchase the wind project each year following the 10<sup>th</sup> anniversary of the commercial operation date at a price determined under the contract.

***Clean Air Act***

We must comply with the requirements under the Clean Air Act (CAA) in operating our thermal generating plants. The CAA currently requires a Title V operating permit for Colstrip (which is in the process of being renewed), Coyote Springs 2 (which will expire in 2013), the Kettle Falls GS (which will be renewed in 2012), and the Rathdrum CT (which will expire in 2016). Boulder Park and the Northeast CT currently require only minor source operating permits based on their limited operation and emissions. The CAA also requires Acid Rain Program monitoring, reporting and emissions trading for Colstrip, Coyote Springs 2 and the Rathdrum CT. We continue to monitor legislative and regulatory developments for several programs within the CAA such as the National Ambient Air Quality Standards (NAAQS), New Source Performance Standards and the National Emission Standards for Hazardous Air Pollutants (NESHAPs) or Maximum Achievable Control Technology (MACT).

***Montana mercury regulation and the EPA's Mercury Air Toxic Standards (MATS)***

In 2006, the Montana Department of Environmental Quality (Montana DEQ) adopted final rules for the control of mercury emissions from coal-fired plants that impose strict emission limitations beginning in 2010. Colstrip installed and is successfully operating a mercury emission control system which meets the Montana mercury regulation.

The EPA finalized the MATS (formerly known as the Utility MACT) on December 16, 2011 to control hazardous air pollutants including mercury from coal and oil-fired power plants. The final version of the rule contains a mercury standard that is less stringent than the Montana mercury regulation; therefore, Colstrip's existing emission control system should be sufficient to meet mercury compliance. For the remaining portion of the rule that specifically addresses Air Toxics (including metals and acid gases), the joint owners are currently evaluating what type of new emission control systems may be needed for MATS compliance in 2015. We are unable to determine to what extent or if there will be any material impacts to Colstrip at this time.

***National Ambient Air Quality Standards (NAAQS)***

We continue to monitor legislative and regulatory developments at both the state and national levels for potential operating limitations that may result from updates to the NAAQS. The CAA requires regular updates which have been recently court mandated to occur in June 2013 for nitrogen dioxide, ozone and particulate matter. We have thermal power plants in Washington, Idaho, Montana and Oregon. Since the EPA has designated most of the western states in which we operate as attainment areas, we do not anticipate any material impacts on our thermal plants from the required updates of these new standards at this time.

***Regional Haze Program***

The United States Congress addressed regional visibility in the 1990 CAA amendments and the EPA published the final Regional Haze regulations in 2005. The EPA's regulations set a national goal of eliminating man-made visibility degradation in Class I areas by the year 2064. The states were expected to take actions through State Implementation Plans (SIPs) to make "reasonable progress" through 10-year plans, including application of Best Available Retrofit Technology (BART) requirements. In 2009, the EPA announced that many states had failed to submit the required SIPs by the 2007 deadline. In 2011, environmental groups sued the EPA for inaction which resulted in court ordered deadlines for a Montana Federal Implementation Plan (FIP) in July 2012.

**AVISTA CORPORATION**

---

BART is a retrofit program applied to large emission sources, including electric generating units built between 1962 and 1977. In February 2007, Colstrip was notified by the EPA that Colstrip Units 1 & 2 (of which we are not an owner) were determined to be subject to the EPA's BART requirements. In November 2010, the EPA issued a request for additional reasonable progress information for Colstrip Units 3 & 4 (of which we are a 15 percent owner). The owners of Colstrip Units 3 & 4 have submitted the requested information and await the EPA's upcoming FIP proposal, which will include the EPA's determination of BART for Colstrip Units 3 & 4. On March 21, 2012, the EPA released a proposed FIP for Montana. The proposal includes emission limitations and pollution controls for Colstrip Units 1 & 2. Colstrip Units 3 & 4 are not currently affected, but would be evaluated for reasonable progress at the next review period in approximately five years. We will continue to evaluate this proposal for any material impacts to Colstrip Units 3 & 4. The FIP is expected to be finalized by the end of 2012.

***Coal Ash Management/Disposal***

Currently, coal combustion byproducts (CCBs) are not regulated by the EPA as a hazardous waste. Under a proposed rule issued in 2010, the EPA is reconsidering the classification of CCBs under the Resource Conservation and Recovery Act (RCRA). The draft rules included two options: to require management of CCBs as a hazardous waste under Subtitle C of the RCRA; or to regulate coal ash under Subtitle D, for non-hazardous solid wastes, with possible special waste requirements. Should the EPA determine to regulate CCBs as a hazardous waste under the RCRA, such action could have a significant impact on future operations of Colstrip.

***Fisheries***

A number of species of fish in the Northwest, including the Snake River sockeye salmon and fall chinook salmon, the Kootenai River white sturgeon, the upper Columbia River steelhead, the upper Columbia River spring chinook salmon and the bull trout, are listed as threatened or endangered under the Federal Endangered Species Act. Efforts to protect these and other species have not directly impacted generation levels at any of our hydroelectric facilities. We purchase power under long-term contracts with certain PUDs with hydroelectric generation projects on the Columbia River that are directly impacted by ongoing mitigation measures for salmon and steelhead. The reduction in generation at these projects is relatively minor, resulting in minimal economic impact on our operations at this time. We cannot predict the economic costs to us resulting from future mitigation measures. We received a 45-year FERC operating license for Cabinet Gorge and Noxon Rapids in March 2001 that incorporates a comprehensive settlement agreement. The restoration of native salmonid fish, including bull trout, is a key part of the agreement. The result is a collaborative native salmonid restoration program with the U.S. Fish and Wildlife Service, Native American tribes and the states of Idaho and Montana on the lower Clark Fork River, consistent with requirements of the FERC license. The U.S. Fish & Wildlife Service issued an updated Critical Habitat Designation for bull trout in 2010 that includes the lower Clark Fork River, as well as portions of the Coeur d'Alene basin within our Spokane River Project area, and is currently developing a final Bull Trout Recovery Plan under the ESA. Issues related to these activities are expected to be worked out through the ongoing collaborative effort of our Clark Fork and Spokane River FERC licenses. See "Hydroelectric Licensing" and "Fish Passage at Cabinet Gorge and Noxon Rapids" in "Note 11 of the Notes to Condensed Consolidated Financial Statements" for further information.

***Western Power Market Issues***

The FERC continues to conduct proceedings and investigations related to market controls within the western United States that include proposals by certain parties to impose refunds, and some of the FERC's decisions have been appealed in Federal Courts. Certain parties have asserted claims for significant refunds from us, which could result in liabilities for refunding revenues recognized in prior periods. We have joined other parties in opposing these proposals. We believe that we have adequate reserves established for refunds that may be ordered. The refund proceedings provide that any refunds would be offset against unpaid energy debts due to the same party. As of June 30, 2012, our accounts receivable outstanding related to defaulting parties in California were fully offset by reserves for uncollected amounts and funds collected from defaulting parties. See "California Refund Proceeding" and "Pacific Northwest Refund Proceeding" in "Note 11 of the Notes to Condensed Consolidated Financial Statements" for further information on the refund proceedings.

***Other***

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

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

Our primary market risk exposures are:

- Commodity prices for electric power and natural gas
- Credit related to the wholesale energy market

## [Table of Contents](#)

### AVISTA CORPORATION

- Interest rates on long-term and short-term debt
- Foreign exchange rates between the U.S. dollar and the Canadian dollar

#### **Commodity Price Risk**

Our qualitative commodity price risk disclosures have not materially changed during the six months ended June 30, 2012. Please refer to the 2011 Form 10-K. The following table presents energy commodity derivative fair values as a net asset or (liability) as of June 30, 2012 that are expected to settle in each respective year (dollars in thousands):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical	Financial	Physical	Financial	Physical	Financial	Physical	Financial
2012	\$(5,542)	\$(20,966)	\$(18,467)	\$(12,121)	\$ 129	\$ 8,205	\$ (901)	\$ 8,756
2013	(2,745)	(16,921)	(19,060)	(18,030)	(63)	15,088	(985)	11,022
2014	(1,973)	115	(6,549)	(5,884)	(135)	2,570	(1,106)	(303)
2015	(1,535)	—	(1,952)	(495)	(167)	(748)	—	(9)
2016	(1,316)	—	(361)	42	(210)	—	—	—
Thereafter	(1,636)	—	—	—	(1,141)	—	—	—

#### **Credit Risk**

Our credit risk has not materially changed during the six months ended June 30, 2012. See the 2011 Form 10-K.

#### **Risk Management for Energy Resources**

We use a variety of techniques to manage risks for energy resources and wholesale energy market activities. We have an energy resources risk policy and control procedures to manage these risks, both qualitative and quantitative. The 2011 Form 10-K contains a discussion of risk management policies and procedures.

#### **Interest Rate Risk**

Our qualitative interest rate risk disclosures have not materially changed during the six months ended June 30, 2012. See the 2011 Form 10-K.

As of June 30, 2012, we had interest rate swap agreements with a notional amount of \$85.0 million and a mandatory cash settlement date of June 2013 (which we entered into in September 2011). In June 2012, we entered into interest rate swap agreements with a notional amount of \$50.0 million and a mandatory cash settlement date of October 2014. We also entered into an interest rate swap agreement with a notional amount of \$25.0 million and a mandatory cash settlement date of October 2015.

As of June 30, 2012, we had a current derivative liability of \$5.2 million and a long-term derivative asset of \$3.4 million, with an offsetting regulatory asset on the Condensed Consolidated Balance Sheets in accordance with regulatory accounting practices. In May 2012, we cash settled interest rate swap contracts (notional amount of \$75.0 million) and paid a total of \$18.5 million. The interest rate swap contracts were settled in connection with the pricing of \$80.0 million of First Mortgage Bonds. Upon settlement of the interest rate swaps, the regulatory asset or liability (included as part of long-term debt) will be amortized as a component of interest expense over the life of the forecasted interest payments.

#### **Foreign Currency Risk**

Our qualitative foreign currency risk disclosures have not materially changed during the six months ended June 30, 2012. See the 2011 Form 10-K. As of June 30, 2012, we had a current derivative asset for foreign currency hedges of less than \$0.1 million included in other current liabilities on the Condensed Consolidated Balance Sheet. As of June 30, 2012, we had entered into 29 Canadian currency forward contracts with a notional amount of \$9.4 million (\$9.6 million Canadian).

Further information for derivatives and fair values is disclosed at “Note 5 of the Notes to Condensed Consolidated Financial Statements” and “Note 9 of the Notes to Condensed Consolidated Financial Statements.”

#### **Item 4. Controls and Procedures**

The Company has disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) to ensure that information required to be disclosed in the reports it files or submits under the Act is recorded, processed, summarized and reported on a timely basis. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Act is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers as appropriate to allow timely decisions regarding required disclosure. Under the supervision and with the participation of the Company’s management, including the Company’s principal executive officer and principal financial officer, the Company has evaluated its disclosure controls and procedures as of the end of the period covered by this report. There are inherent

**AVISTA CORPORATION**

---

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. Disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Based upon the Company's evaluation, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures are effective at a reasonable assurance level as of June 30, 2012.

There have been no changes in the Company's internal control over financial reporting that occurred during the second quarter of 2012 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 Condensed Consolidated Financial Statements" in "Part I. Financial Information Item 1. Condensed Consolidated Financial Statements."

**Item 1A. Risk Factors**

Please refer to the 2011 Form 10-K for disclosure of risk factors that could have a significant impact on our results of operations, financial condition or cash flows and could cause actual results or outcomes to differ materially from those discussed in our reports filed with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q), and elsewhere. These risk factors have not materially changed from the disclosures provided in the 2011 Form 10-K. In addition to these risk factors, see also "Forward-Looking Statements" for additional factors which could have a significant impact on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 6. Exhibits**

- 3.1 Restated Articles of Incorporation of Avista Corporation, as amended and restated June 6, 2012
- 12 Computation of ratio of earnings to fixed charges\*
- 15 Letter Re: Unaudited Interim Financial Information\*
- 31.1 Certification of Chief Executive Officer (Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)\*
- 31.2 Certification of Chief Financial Officer (Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)\*
- 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)\*\*
- 101 The following financial information from the Quarterly Report on Form 10-Q for the period ended June 30, 2012, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Condensed Consolidated Statements of Income; (ii) Condensed Consolidated Statements of Comprehensive Income; (iii) the Condensed Consolidated Balance Sheets; (iv) the Condensed Consolidated Statements of Cash Flows; (v) the Condensed Consolidated Statements of Equity and Redeemable Noncontrolling Interests; and (vi) the Notes to Condensed Consolidated Financial Statements.\*\*

\* Filed herewith.

\*\* Furnished herewith.

SIGNATURE

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

AVISTA CORPORATION  
(Registrant)

Date: August 7, 2012

/s/ Mark T. Thies

---

Mark T. Thies  
Senior Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

RESTATED ARTICLES  
OF INCORPORATION

OF

AVISTA CORPORATION

**As Amended and Restated June 6, 2012**

**RESTATED**

**ARTICLES OF INCORPORATION OF**

**AVISTA CORPORATION**

Know all men by these presents that we have this day voluntarily associated ourselves together for the purpose of forming, and we do hereby form and agree to become a Corporation, under and by virtue of the laws of the Territory of Washington, and for such purpose we do hereby certify:

**FIRST:** That the name of said Corporation is Avista Corporation.

**SECOND:** The objects and purposes for which the Corporation is formed are:

To acquire, buy, hold, own, sell, lease, exchange, dispose of, finance, deal in, construct, build, equip, improve, use, operate, maintain and work upon:

- (a) Any and all kinds of plants and systems for the manufacture, production, storage, utilization, purchase, sale, supply, transmission, distribution or disposition of electric energy, natural or artificial gas, water or steam, or power produced thereby, or of ice and refrigeration of any and every kind;
- (b) Any and all kinds of telephone, telegraph, radio, wireless and other systems, facilities and devices for the receipt and transmission of sounds and signals, any and all kinds of interurban, city and street railways and bus lines for the transportation of passengers and/or freight, transmission lines, systems, appliances, equipment and devices and tracks, stations, buildings and other structures and facilities;
- (c) Any and all kinds of works, power plants, manufactories, structures, substations, systems, tracks, machinery, generators, motors, lamps, poles, pipes, wires, cables, conduits, apparatus, devices, equipment, supplies, articles and merchandise of every kind pertaining to or in anywise connected with the construction, operation or maintenance of telephone, telegraph, radio, wireless and other systems, facilities and devices for the receipt and transmission of sounds and signals, or of interurban, city and street railways and bus lines, or in anywise connected with or pertaining to the manufacture, production, purchase, use, sale, supply, transmission, distribution, regulation, control or application of electric energy, natural or artificial gas, water, steam, ice, refrigeration and power or any other purpose;

To acquire, buy, hold, own, sell, lease, exchange, dispose of, transmit, distribute, deal in, use, manufacture, produce, furnish and supply street and interurban railway and bus service, electric energy, natural or artificial gas, light, heat, ice, refrigeration, water and steam in any form and for any purposes whatsoever; and any power or force, or energy in any form and for any purposes whatsoever;

To manufacture, produce, buy or in any other manner acquire, and to sell, furnish, dispose of and distribute steam for heating or other purposes, and to purchase, lease or otherwise acquire, build, construct, erect, hold, own, improve, enlarge, maintain, operate, control, supervise and manage and to sell, lease or otherwise dispose of plants, works and facilities, including distribution systems, mains, pipes, conduits and meters, and all other necessary apparatus and appliances used or useful or convenient for use in the business of manufacturing, producing, selling, furnishing, disposing of and distributing steam for heating or for any other purposes;

To acquire, organize, assemble, develop, build up and operate constructing and operating and other organizations and systems, and to hire, sell, lease, exchange, turn over, deliver and dispose of such organizations and systems in whole or in part and as going organizations and systems and otherwise, and to enter into and perform contracts, agreements and undertakings of any kind in connection with any or all of the foregoing powers;

To do a general contracting business;

To purchase, acquire, develop, mine, explore, drill, hold, own, sell and dispose of lands, interest in and rights with respect to lands and waters and fixed and movable property;

To plan, design, construct, alter, repair, remove or otherwise engage in any work upon bridges, dams, canals, piers, docks, wharfs, buildings, structures, foundations, mines, shafts, tunnels, wells, waterworks and all kinds of structural excavations and subterranean work and generally to carry on the business of contractors and engineers;

To manufacture, improve and work upon and to deal in, purchase, hold, sell and convey minerals, metals, wood, oils and other liquids, gases, chemicals, animal and plant products or any of the products and by-products thereof or any article or thing into the manufacture of which any of the foregoing may enter;

To manufacture, improve, repair and work upon and to deal in, purchase, hold, sell and convey any and all kinds of machines, instruments, tools, implements, mechanical devices, engines, boilers, motors, generators, rails, cars, ships, boats, launches, automobiles, trucks, tractors, airships, aeroplanes, articles used in structural work, building materials, hardware, textiles, clothing, cloth, leather goods, furs and any other goods, wares and merchandise of whatsoever kind;

To construct, erect and sell buildings and structures in and on any lands for any use or purpose; to equip and operate warehouses, office buildings, hotels, apartment houses, apartment hotels and restaurants, or any other buildings and structures of whatsoever kind;

To guarantee, purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of the state of Washington or of any other state or government, and, while the owner of such stock, to exercise all the rights, powers and privileges of individual ownership with respect thereto, including the right to vote thereon, and to consent and otherwise act with respect thereto;

To aid in any manner any corporation or association, domestic or foreign, or any firm or individual, any shares of stock in which or any bonds, debentures, notes, securities, evidence of indebtedness, contracts or obligations of which are held by or for the Corporation or in which or in the welfare of which the Corporation shall have any interest, and to do any acts designed to protect, preserve, improve or enhance the value of any property at any time held or controlled by the Corporation, or in which it may be interested at any time; and to organize or promote or facilitate the organization of subsidiary companies;

To purchase from time to time any of its stock outstanding (so far as may be permitted by law) at such price as may be fixed by its Board of Directors or Executive Committee and accepted by the holders of the stock purchased, and to resell any stock so purchased at such price as may be fixed by its said Board of Directors or Executive Committee;

In any manner to acquire, enjoy, utilize and to sell or otherwise dispose of patents, copyrights and trademarks and any licenses or other rights or interests therein and thereunder;

To purchase, acquire, hold, own and sell or otherwise dispose of franchises, concessions, consents, privileges and licenses;

To borrow money and contract debts, to issue bonds, promissory notes, bills of exchange, debentures and other obligations and evidences of indebtedness payable at a specified time or times or payable upon the happening of a specified event or events, whether secured by mortgage, pledge or otherwise or unsecured, for money borrowed or in payment for property purchased or acquired or any other lawful objects; all as may be determined from time to time by the Board of Directors or Executive Committee of the Corporation, pursuant to the authority hereby conferred;

To create mortgages or deeds of trust which shall cover and create a lien upon all or any part of the property of the Corporation of whatsoever kind and wheresoever situated, then owned or thereafter acquired, and to provide in any such mortgage or deed of trust that the amount of bonds or other evidences of indebtedness to be issued thereunder and to be secured thereby shall be limited to a definite amount or limited only by the conditions therein specified and to issue or cause to be issued by the Corporation the bonds or other evidences of indebtedness to be secured thereby; all as may be determined from time to time by the Board of Directors or Executive Committee of the Corporation pursuant to the authority hereby conferred;

To do all and everything necessary and proper for the accomplishment of the objects enumerated in these Articles of Incorporation or any amendment thereof or necessary or incidental to the protection and benefit of the Corporation, and in general to carry on any lawful business necessary or incidental to the attainment of the objects of the Corporation whether or not such business is similar in nature to the objects set forth in these Articles of Incorporation or any amendment thereof;

To do any or all things herein set forth, to the same extent and as fully as natural persons might or could do, and in any part of the world, and as principal, agent, contractor or otherwise, and either alone or in conjunction with any other persons, firms, associations or corporations;

To conduct its business in any or all its branches in the state of Washington, other states, the District of Columbia, the territories and colonies of the United States, and any foreign countries, and to have one or more offices out of the state of Washington.

**THIRD:**

- (a) The amount of capital with which the Corporation will begin to carry on business hereunder shall be FIVE MILLION FIVE HUNDRED DOLLARS (\$5,000,500).
- (b) The aggregate number of shares of capital stock which the Corporation shall have authority to issue is 210,000,000 shares, divided into 10,000,000 shares of Preferred Stock without nominal or par value, issuable in series as hereinafter provided, and 200,000,000 shares of Common Stock without nominal or par.
- (c) A statement of the preferences, limitations and relative rights of each class of capital stock of the Corporation, namely, the Preferred Stock without nominal or par value and the Common Stock without nominal or par value, of the variations in the relative rights and preferences as between series of the Preferred Stock insofar as the same are fixed by these Articles of Incorporation, and of the authority vested in the Board of Directors of

the Corporation to establish series of Preferred Stock and to fix and determine the variations in the relative rights and preferences as between series insofar as the same are not fixed by these Articles of Incorporation and as to which there may be variations between series is as follows.

- (d) The shares of the Preferred Stock may be divided into and issued in series. Each series shall be so designated as to distinguish the shares thereof from the shares of all other series of the Preferred Stock and all other classes of capital stock of the Corporation. To the extent that these Articles of Incorporation shall not have established series of the Preferred Stock and fixed and determined the variations in the relative rights and preferences as between series, the Board of Directors shall have authority, and is hereby expressly vested with authority, to divide the Preferred Stock into series and, within the limitations set forth in these Articles of Incorporation and such limitations as may be provided by law, to fix and determine the relative rights and preferences of any series of the Preferred Stock so established. Such action by the Board of Directors shall be expressed in a resolution or resolutions adopted by it prior to the issuance of shares of each series, which resolution or resolutions shall also set forth the distinguishing designation of the particular series of the Preferred Stock established thereby. Without limiting the generality of the foregoing, authority is hereby expressly vested in the Board of Directors so to fix and determine, with respect to any series of the Preferred Stock:
- (1) the rate or rates of dividend, if any, which may be expressed in terms of a formula or other method by which such rate or rates shall be calculated from time to time, and the date or dates on which dividends may be payable;
  - (2) whether shares may be redeemed and, if so, the redemption price and the terms and conditions of redemption;
  - (3) the amount payable upon shares in event of voluntary and involuntary liquidation;
  - (4) sinking fund provisions, if any, for the redemption or purchase of shares; and
  - (5) the terms and conditions, if any, on which shares may be converted.

All shares of the Preferred Stock of the same series shall be identical except that shares of the same series issued at different times may vary as to the dates from which dividends thereon shall be cumulative; and all shares of the Preferred Stock, irrespective of series, shall constitute one and the same class of stock, shall be of equal rank, and shall be identical except as to the designation thereof, the date or dates from which dividends on shares thereof shall be cumulative, and the relative rights and preferences set forth above in clauses (1) through (5) of this subdivision (d), as to which there may be variations between different series. Except as may be otherwise provided by law, by subdivision (j) of this Article THIRD, or by the resolutions establishing any series of Preferred Stock in accordance with the foregoing provisions of this subdivision (d), whenever the written consent, affirmative vote, or other action on the part of the holders of the Preferred Stock may be required for any purpose, such consent, vote or other action shall be taken by the holders of the Preferred Stock as a single class irrespective of series and not by different series.

- (e) Out of any funds legally available for the payment of dividends, the holders of the Preferred Stock of each series shall be entitled, in preference to the holders of the Common Stock, to receive, but only when and as declared by the Board of Directors, dividends at the rate or rates fixed and determined with respect to each series in accordance with these Articles of Incorporation, and no more, payable as hereinafter provided. Such dividends shall be cumulative so that if for all past dividend periods and the then current dividend periods dividends shall not have been paid or declared and set apart for payment on all outstanding shares of each series of the Preferred Stock, at the dividend rates fixed and determined for the respective series, the deficiency shall be fully paid or declared and set apart for payment before any dividends on the Common Stock shall be paid or declared and set apart for payment; provided, however, that nothing in this subdivision (e) or elsewhere in these Articles of Incorporation shall prevent the simultaneous declaration and payment of dividends on both the Preferred Stock and the Common Stock if there are sufficient funds legally available to pay all dividends concurrently. Dividends on all shares of the Preferred Stock of each series shall be cumulative from the date of issuance of shares of such series. If more than one series of the Preferred Stock shall be outstanding and if dividends on each series shall not have been paid or declared and set apart for payment, at the dividend rate or rates fixed and determined for such series, the shares of the Preferred Stock of each series shall share ratably in the payment of dividends including accumulations, if any, in accordance with the sums which would be payable on such shares if all dividends were declared and paid in full. As to all series of Preferred Stock, the dividend payment dates for regular dividends shall be the fifteenth day of March, June, September and December in each year, unless other dividend payment dates shall have been fixed and determined for any series in accordance with subdivision (d) of this Article THIRD, and the dividend period in respect of which each regular dividend shall be payable in respect of each series shall be the period commencing on the next preceding dividend payment date for such series and ending on the day next preceding the dividend payment date for such dividend. No interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments which may be in arrears.
- (f) Subject to the limitations set forth in paragraph (e) or elsewhere in these Articles of Incorporation (and subject to the rights of any class of stock hereafter authorized), dividends may be paid on the Common Stock when and as declared by the Board of Directors out of any funds legally available for the payment of dividends, and no holder of shares of any series of the Preferred Stock as such shall be entitled to share therein.
- (g) In the event of any voluntary dissolution, liquidation or winding up of the Corporation, before any distribution or payment shall be made to the holders of the Common Stock, the holders of the Preferred Stock of each series then outstanding shall be entitled to receive out of the net assets of the Corporation available for distribution to its shareholders the respective amounts per share fixed and determined in accordance with these Articles of Incorporation to be payable on the shares of such series in the event of voluntary liquidation, and no more, and in the event of any involuntary dissolution, liquidation or winding up of the Corporation, before any distribution or payment shall be made to the holders of the Common Stock, the holders of the Preferred Stock of each series then outstanding shall be entitled to receive out of the net assets of the Corporation available for distribution to its shareholders the respective amounts per share fixed and determined in accordance with these Articles of Incorporation to be payable on the shares of such series in the event of involuntary liquidation, and no more. If upon any dissolution, liquidation or winding up of the Corporation, whether voluntary or

involuntary, the net assets of the Corporation available for distribution to its shareholders shall be insufficient to pay the holders of all outstanding shares of Preferred Stock of all series the full amounts to which they shall be respectively entitled as aforesaid, the entire net assets of the Corporation available for distribution shall be distributed ratably to the holders of all outstanding shares of Preferred Stock of all series in proportion to the amounts to which they shall be respectively so entitled. For the purposes of this and the next succeeding subdivision, and without limiting the right of the Corporation to distribute its assets or to dissolve, liquidate or wind up in connection with any sale, merger or consolidation, the sale of all or substantially all of the property of the Corporation, or the merger or consolidation of the Corporation into or with any other corporation or corporations, shall not be deemed to be a distribution of assets or a dissolution, liquidation or winding up of the Corporation, whether voluntary or involuntary.

- (h) Subject to the limitations set forth in subdivision (g) of this Article THIRD or elsewhere in these Articles of Incorporation (and subject to the rights of any class of stock hereafter authorized) upon any dissolution, liquidation or winding up of the Corporation, whether voluntary or involuntary, any net assets of the Corporation available for distribution to its shareholders shall be distributed ratably to holders of the Common Stock.
- (i) The Preferred Stock may be redeemed in accordance with the following provisions of this subdivision (i):
  - (1) Each series of the Preferred Stock which has been determined to be redeemable as permitted by subdivision (d) of this Article THIRD may be redeemed in whole or in part by the Corporation, at its election expressed by resolution of the Board of Directors, at any time or from time to time, at the then applicable redemption price fixed and determined with respect to each series, subject however, to any terms and conditions specified in respect of any series of the Preferred Stock in accordance with subdivision (d) of this Article THIRD. If less than all of the shares of any series are to be redeemed, the redemption shall be made either pro rata or by lot in such manner as the Board of Directors shall determine.
  - (2) In the event the Corporation shall so elect to redeem shares of the Preferred Stock, notice of the intention of the Corporation to do so and of the date and place fixed for redemption shall be mailed not less than thirty nor more than ninety days before the date fixed for redemption to each holder of shares of the Preferred Stock to be redeemed at his address as it shall appear on the books of the Corporation, and on and after the date fixed for redemption and specified in such notice (unless the Corporation shall default in making payment of the redemption price), such holders shall cease to be shareholders of the Corporation with respect to such shares and shall have no interest in or claim against the Corporation with respect to such shares, excepting only the right to receive the redemption price therefor from the Corporation on the date fixed for redemption, without interest, upon endorsement, if required, and surrender of their certificates for such shares.
  - (3) Contemporaneously with the mailing of notice of redemption of any shares of the Preferred Stock as aforesaid or at any time thereafter on or before the date fixed for redemption, the Corporation may, if it so elects, deposit the aggregate redemption price of the shares to be redeemed with any bank or trust company

doing business in the City of New York, New York, or Spokane, Washington, having a capital and surplus of at least \$5,000,000, named in such notice, payable on the date fixed for redemption in the proper amounts to the respective holders of the shares to be redeemed, upon endorsement, if required, and surrender of their certificates for such shares, and on and after the making of such deposit such holders shall cease to be shareholders of the Corporation with respect to such shares and shall have no interest in or claim against the Corporation with respect to such shares, excepting only the right to exercise such redemption or exchange rights, if any, on or before the date fixed for redemption as may have been provided with respect to such shares or the right to receive the redemption price of their shares from such bank or trust company on the date fixed for redemption, without interest, upon endorsement, if required, and surrender of their certificates for such shares.

- (4) If the Corporation shall have so elected to deposit the redemption moneys with a bank or trust company, any moneys so deposited which shall remain unclaimed at the end of six years after the redemption date shall be repaid to the Corporation, and upon such repayment holders of Preferred Stock who shall not have made claim against such moneys prior to such repayment shall be deemed to be unsecured creditors of the Corporation for an amount, without interest, equal to the amount they would theretofore have been entitled to receive from such bank or trust company. Any redemption moneys so deposited which shall not be required for such redemption because of the exercise, after the date of such deposit, of any right of conversion or exchange or otherwise, shall be returned to the Corporation forthwith. The Corporation shall be entitled to receive any interest allowed by any bank or trust company on any moneys deposited with such bank or trust company as herein provided, and the holders of any shares called for redemption shall have no claim against any such interest.
  - (5) Nothing herein contained shall limit any legal right of the Corporation to purchase or otherwise acquire any shares of the Preferred Stock.
- (j) The holders of the Preferred Stock shall not have any right to vote for the election of Directors or for any other purpose except as otherwise provided by law and as set forth below in this subdivision of this Article THIRD or elsewhere in these Articles of Incorporation. Holders of Preferred Stock shall be entitled to notice of each meeting of shareholders at which they shall have any right to vote but except as may be otherwise provided by law shall not be entitled to notice of any other meeting of shareholders.
- (1) Whenever and as often as, at any date, dividends payable on any shares of the Preferred Stock shall be in arrears in an amount equal to the aggregate amount of dividends accumulated on such shares of the Preferred Stock over the eighteen-month period ended on such date, the holders of the Preferred Stock of all series, voting separately and as a single class, shall be entitled to vote for and to elect a majority of the Board of Directors, and the holders of the Common Stock, voting separately and as a single class, shall be entitled to vote for and to elect the remaining Directors of the Corporation. The right of the holders of the Preferred Stock to elect a majority of the Board of Directors shall, however, cease when all defaults in the payment of dividends on their stock shall have been cured and such dividends shall be declared and paid out of any funds legally available therefor as soon as in the judgment of the Board of Directors is reasonably

practicable. The terms of office of all persons who may be Directors of the Corporation at the time the right to elect Directors shall accrue to the holders of the Preferred Stock as herein provided shall terminate upon the election of their successors at a meeting of the shareholders of the Corporation then entitled to vote. Such election shall be held at the next Annual Meeting of Shareholders or may be held at a special meeting of shareholders but shall be held upon notice as provided in the Bylaws of the Corporation for a special meeting of the shareholders. Any vacancy in the Board of Directors occurring during any period when the Preferred Stock shall have elected representatives on the Board shall be filled by a majority vote of the remaining Directors representing the class of stock theretofore represented by the Director causing the vacancy. At all meetings of the shareholders held for the purpose of electing Directors during such times as the holders of the Preferred Stock shall have the exclusive right to elect a majority of the Board of Directors of the Corporation, the presence in person or by proxy of the holders of a majority of the outstanding shares of Preferred Stock of all series shall be required to substitute a quorum of such class for the election of Directors, and the presence in person or by proxy of the holders of a majority of the outstanding shares of Common Stock shall be required to constitute a quorum of such class for the election of Directors; provided, however, that the absence of a quorum of the holders of stock of either class shall not prevent the election at any such meeting, or adjournment thereof, of Directors by the other class if the necessary quorum of the holders of stock of such class is present in person or by proxy at such meeting; and provided further, that, in the absence of a quorum of the holders of stock of either class, a majority of those holders of such stock who are present in person or by proxy shall have the power to adjourn the election of those Directors to be elected by that class from time to time without notice, other than announcement at the meeting, until the requisite amount of holders of stock of such class shall be present in person or by proxy.

- (2) So long as any shares of the Preferred Stock shall be outstanding, the Corporation shall not, without the affirmative vote of the holders of at least a majority of the shares of the Preferred Stock at the time outstanding, adopt any amendment to these Articles of Incorporation if such amendment would:
- (i) create or authorize any new class of stock ranking prior to or on a parity with the Preferred Stock as to dividends or upon dissolution, liquidation or winding up;
  - (ii) increase the authorized number of shares of the Preferred Stock; or
  - (iii) change any of the rights or preferences of the Preferred Stock at the time outstanding provided, however, that if any proposed change of any of the rights or preferences of any outstanding shares of the Preferred Stock would affect the holders of shares of one or more, but not all, series of the Preferred Stock then outstanding, only the affirmative vote of the holders of at least a majority of the total number of outstanding shares of all series so affected shall be required; and provided further, that nothing herein shall authorize the adoption of any amendment to these Articles of Incorporation by the vote of the holders of a lesser number of shares of the Preferred Stock, or of any other class of stock, or of all classes of stock, than is required for such an amendment by the laws of the state of Washington at the time applicable thereto.

- (3) So long as any shares of the Preferred Stock shall be outstanding, the Corporation shall not, without the affirmative vote of the holders of at least a majority of the shares of the Preferred Stock at the time outstanding, issue any shares of the Preferred Stock, or of any other class of stock ranking prior to or on a parity with the Preferred Stock as to dividends or upon dissolution, liquidation or winding up, unless the net income of the Corporation available for the payment of dividends for a period of twelve consecutive calendar months within the fifteen calendar months immediately preceding the issuance of such shares (including, in any case in which such shares are to be issued in connection with the acquisition of new property, the net income of the property so to be acquired, computed on the same basis as the net income of the Corporation) is at least equal to one and one-half times the annual dividend requirements on all shares of the Preferred Stock, and on all shares of all other classes of stock ranking prior to or on a parity with the Preferred Stock as to dividends or upon dissolution, liquidation or winding up, which will be outstanding immediately after the issuance of such shares, including the shares proposed to be issued; provided, however, that if the shares of any series of the Preferred Stock or any such prior or parity stock shall have a variable dividend rate, the annual dividend requirement on the shares of such series shall be determined by reference to the weighted average dividend rate on such shares during the twelve-month period for which the net income of the Corporation available for the payment of dividends shall have been determined; and provided, further, that if the shares of the series to be issued are to have a variable dividend rate, the annual dividend requirement on the shares of such series shall be determined by reference to the initial dividend rate upon the issuance of such shares. In any case where it would be appropriate, under generally accepted accounting principles to combine or consolidate the financial statements of any parent or subsidiary of the Corporation with those of the Corporation, the foregoing computation may be made on the basis of such combined or consolidated financial statements.
- (k) Subject to the limitations set forth in subdivision (j) of this Article THIRD (and subject to the rights of any class of stock hereafter authorized), and except as may be otherwise provided by law, the holders of the Common Stock shall have the exclusive right to vote for the election of Directors and for all other purposes. At each meeting of shareholders, each holder of stock entitled to vote thereat shall be entitled to one vote for each share of such stock held by him and recorded in his name on the record date for such meeting, and may vote and otherwise act in person or by proxy. Voting in the election of directors by shares within each voting group shall be governed by the additional provisions set forth below:
- (1) In an election of directors which is not a contested election (as defined below):
- (A) Each vote entitled to be cast may be cast for or cast against one or more candidates, or a shareholder may indicate an abstention with respect to one or more candidates. Shareholders shall not be entitled to cumulate votes;

- (B) A candidate shall be elected by such voting group if the number of votes cast within such voting group for such candidate exceeds the number of votes cast within such voting group against such candidate. A candidate who does not receive such majority of votes cast but who is a director at the time of the election shall continue to serve as a director for a term that shall terminate on the date that is the earliest of (I) the date of the commencement of the term of a new director selected by the board of directors to fill the office held by such director, (II) the effective date of the resignation of such director and (III) the later of (X) the last day of the sixth calendar month commencing after the election in which such candidate failed to receive a majority of votes cast and (Y) December 31 of the calendar year on which such election occurred;
  - (C) Only votes cast for and votes cast against a candidate shall be taken into account in determining whether the votes required for the election of such candidate have been received. Shares otherwise present at the meeting but for which there is an abstention with respect to a candidate or as to which no authority or direction to vote is given or specified with respect to a candidate shall not be deemed to have been voted; and
  - (D) In the event that a director does not receive the required majority vote for election, a majority of the other directors duly elected by shares within such voting group in such or a prior election may select any qualified individual to fill the office held by such director, such selection being deemed to constitute the filling of a vacancy.
- (2) In a contested election:
- (A) Each vote entitled to be cast may be cast for one or more candidates (not to exceed the number of directors to be elected), or may be withheld with respect to one or more candidates. Shareholders shall not be entitled to cumulate votes; and
  - (B) The candidates elected shall be those receiving the largest numbers of votes cast within such voting group, up to the number of directors to be elected.
- (3) An election of directors by a voting group shall be deemed to be a “contested election” with respect to such voting group if at the expiration of the time fixed in the Bylaws requiring advance notice of a shareholder’s intent to nominate a person for election as a director, there are more candidates for election by such voting group than the number of directors to be elected by such voting group, one or more of whom have been properly proposed by shareholders.
- (l) Subject to the limitations set forth in subdivision (j) of this Article THIRD (and subject to the rights of any class of stock hereafter authorized), and except as may be otherwise provided by law, upon the vote of a majority of all of the Directors of the Corporation and of the holders of record of a majority of the total number of shares of the Corporation then issued and outstanding and entitled to vote (or, if the vote of a larger number or different proportion of shares is required by the laws of the state of Washington, notwithstanding the above agreement of the shareholders of the Corporation to the

contrary, then upon the vote of the holders of record of the larger number or different proportion of shares so required) the Corporation may from time to time create or authorize one or more other classes of stock with such preferences, designations, rights, privileges, powers, restrictions, limitations and qualifications as may be determined by said vote, which may be the same or different from the preferences, designations, rights, privileges, powers, restrictions, limitations and qualifications of the classes of stock of the Corporation then authorized and/or the Corporation may increase or decrease the number of shares of one or more of the classes of stock then authorized.

- (m) All stock of the Corporation without nominal or par value whether authorized herein or upon subsequent increases of capital stock or pursuant to any amendment hereof may be issued, sold and disposed of by the Corporation from time to time for such consideration in labor, services, money or property as may be fixed from time to time by the Board of Directors and authority to the Board of Directors so to fix such consideration is hereby granted by the shareholders. The consideration received by the Corporation from the issuance and sale of new or additional shares of capital stock without par value shall be entered in the capital stock account.
- (n) No holder of any stock of the Corporation shall be entitled as of right to purchase or subscribe for any part of any stock of the Corporation authorized herein or of any additional stock of any class to be issued by reason of any increase of the authorized capital stock of the Corporation or of any bonds, certificates of indebtedness, debentures or other securities convertible into stock of the Corporation but any stock authorized herein or any such additional authorized issue of any stock or of securities convertible into stock may be issued and disposed of by the Board of Directors to such persons, firms, corporations or associations upon such terms and conditions as the Board of Directors in their discretion may determine without offering any thereof on the same terms or any terms to the shareholders then of record or to any class of shareholders.

**FOURTH:** The duration of the Corporation shall be perpetual.

**FIFTH:** The number of Directors of the Corporation shall be such number, not to exceed eleven (11), as shall be specified from time to time by the Board of Directors in the Bylaws; provided, however, that if the right to elect a majority of the Board of Directors shall have accrued to the holders of the Preferred Stock as provided in paragraph (1) of subdivision (j) of Article THIRD, then, during such period as such holders shall have such right, the number of Directors may exceed eleven (11). Commencing with the 2012 Annual Meeting of Shareholders, Directors shall be elected at each Annual Meeting of Shareholders for a term which shall expire at the next Annual Meeting of Shareholders; it being understood that the term of each Director elected prior to the 2012 Annual Meeting of Shareholders for a term that was to expire after the 2012 Annual Meeting of Shareholders shall expire at the 2012 Annual Meeting of Shareholders. Directors elected by the holders of the Preferred Stock in accordance with paragraph (1) of subdivision (j) of Article THIRD shall be elected for a term that shall expire not later than the next Annual Meeting of Shareholders. All Directors shall hold office until the expiration of their respective terms of office and until their successors shall have been elected and qualified.

Subject to the provisions of paragraph (1) of subdivision (j) of Article THIRD, any vacancy occurring in the Board of Directors may be filled by the Board of Directors, and any Director so elected to fill a vacancy shall be elected for a term of office continuing until the next election of Directors by the shareholders; provided, however, if the Directors then in office constitute fewer than a quorum of the Board, the affirmative vote of a majority of all Directors then in office shall be required to fill such vacancy.

No decrease in the number of Directors constituting the Board of Directors shall shorten the term of any incumbent Director.

Subject to the provisions of paragraph (1) of subdivision (j) of Article THIRD and the provisions of the next preceding paragraph of this Article FIFTH, any Director may be removed from office at any time, but only for cause, only by the holders of shares of capital stock of the Corporation entitled generally to vote in the election of Directors (such stock being hereinafter in these Articles of Incorporation called "Voting Stock," voting together as a single class, at a meeting of shareholders called expressly for that purpose and only if the number of votes cast for the removal of such Director exceeds the number of votes cast against such removal.

Notwithstanding anything contained in these Articles of Incorporation to the contrary, the provisions of this Article FIFTH shall not be altered, amended or repealed, and no provision inconsistent therewith shall be included in these Articles of Incorporation or the Bylaws of the Corporation, without the affirmative vote of the holders of at least eighty percent (80%) of the voting power of all of the shares of the Voting Stock, voting together as a single class.

**SIXTH:** That the principal place of business of said Corporation shall be Spokane, Spokane County, Washington.

**SEVENTH:** The corporate powers shall be exercised by the Board of Directors, except as otherwise provided by statute or by these Articles of Incorporation. The Board of Directors shall have power to authorize the payment of compensation to the Directors for services to the Corporation, including fees for attendance at meetings of the Board of Directors and other meetings, and to determine the amount of such compensation and fees.

The Board of Directors shall have power to adopt, alter, amend and repeal the Bylaws of the Corporation. To the extent provided under the laws of the state of Washington, any Bylaws adopted by the Directors under the powers conferred hereby may be repealed or changed by the shareholders.

An Executive Committee may be appointed by and from the Board of Directors in such manner and subject to such regulations as may be provided in the Bylaws, which committee shall have and may exercise, when the Board is not in session, all the powers of said Board which may be lawfully delegated subject to such limitations as may be provided in the Bylaws or by resolutions of the Board. The fact that the Executive Committee has acted shall be conclusive evidence that the Board was not in session at the time of such action. Additional committees may be appointed by and from the Board of Directors in such manner and subject to such regulations as may be provided in the Bylaws. Any action required or permitted by these Articles of Incorporation to be taken by the Board of Directors of the Corporation may be taken by a duly authorized committee of the Board of Directors, except as otherwise required by law.

No Director shall have any personal liability to the Corporation or its shareholders for monetary damages for his or her conduct as a Director of the Corporation; provided, however, that nothing herein shall eliminate or limit any liability which may not be so eliminated or limited under Washington law, as from time to time in effect. No amendment, modification or repeal of this paragraph shall eliminate or limit the protection afforded by this paragraph with respect to any act or omission occurring prior to the effective date thereof.

The Corporation shall, to the full extent permitted by applicable law, as from time to time in effect, indemnify any person made a party to, or otherwise involved in, any proceeding by reason of the fact that he or she is or was a Director of the Corporation against judgments, penalties, fines, settlements and reasonable expenses actually incurred by him or her in connection with such proceeding. The

Corporation shall pay any reasonable expenses incurred by a Director in connection with any such proceeding in advance of the final determination thereof upon receipt from such Director of such undertakings for repayment as may be required by applicable law and a written affirmation by such director that he or she has met the standard of conduct necessary for indemnification, but without any prior determination, which would otherwise be required by Washington law, that such standard of conduct has been met. The Corporation may enter into agreements with each Director obligating the Corporation to make such indemnification and advances of expenses as are contemplated herein. Notwithstanding the foregoing, the Corporation shall not make any indemnification or advance which is prohibited by applicable law. The rights to indemnity and advancement of expenses granted herein shall continue as to any person who has ceased to be a Director and shall inure to the benefit of the heirs, executors and administrators of such a person.

A Director of the Corporation shall not be disqualified by his office from dealing or contracting with this Corporation either as a vendor, purchaser or otherwise, nor shall any transaction or contract of the Corporation be void or voidable by reason of the fact that any Director, or any firm of which any Director is a member, or any corporation of which any Director is a shareholder or Director, is in any way interested in such transaction or contract, provided that such transaction or contract is or shall be authorized, ratified, or approved, either (1) by vote of a majority of a quorum of the Board of Directors or of the Executive Committee without counting in such majority or quorum any Directors so interested, or a member of a firm so interested, or a shareholder or Director of a corporation so interested; or (2) by the written consent or by vote at a shareholders' meeting of the holders of record of a majority in number of all the outstanding shares of capital stock of the Corporation entitled to vote; nor shall any Director be liable to account to the Corporation for any profits realized by and from or through any such transaction or contract of the Corporation authorized, ratified, or approved as aforesaid by reason of the fact that he, or any firm of which he is a member, or any corporation of which he is a shareholder or a Director, was interested in such transaction or contract. Nothing herein contained shall create any liability in the events above described or prevent the authorization, ratification or approval of such transaction or contract in any other manner approved by law.

Shareholders shall have no rights, except as conferred by statute or by the Bylaws, to inspect any book, paper or account of the Corporation.

In any circumstance in which Washington law would require the approval of shareholders to authorize (1) the merger of the Corporation with or into another entity or a statutory share exchange with another entity, (2) a sale, lease, exchange or other disposition of property of the Corporation or (3) the dissolution of the Corporation, the requisite shareholder approval shall be the affirmative vote of the holders of a majority of the outstanding shares of capital stock entitled to vote on such transaction, unless Washington law shall require a higher standard.

Special meetings of the shareholders may be called by the President, the Chairman of the Board of Directors, a majority of the Board of Directors, any Executive Committee of the Board of Directors, and shall be called by the President at the request of the holders of at least two-thirds (2/3) of the voting power of all of the shares of the Voting Stock, voting together as a single class. Only those matters that are specified in the call of or request for a special meeting may be considered or voted upon at such meeting.

Notwithstanding anything contained in these Articles of Incorporation to the contrary, the paragraph in this Article SEVENTH relating to the adoption, alteration, amendment, change and repeal of the Bylaws of the Corporation, the paragraph in this Article SEVENTH relating to the calling and conduct of special meetings of the shareholders and this paragraph, and the provisions of the Bylaws of the Corporation relating to procedures for the nomination of Directors, shall not be altered, amended or

repealed, and no provision inconsistent therewith shall be included in these Articles of Incorporation or the Bylaws of the Corporation, without the affirmative vote of the holders of at least eighty percent (80%) of the voting power of all the shares of the Voting Stock, voting together as a single class.

**EIGHTH:**

- (a) In addition to any affirmative vote required by law or these Articles of Incorporation, and except as otherwise expressly provided in subdivision (b) of this Article EIGHTH:
- (1) any merger or consolidation of the Corporation or any Subsidiary (as hereinafter defined) with (a) any Interested Shareholder (as hereinafter defined) or (b) any other corporation (whether or not itself an Interested Shareholder) which is, or after such merger or consolidation would be, an Affiliate (as hereinafter defined) of an Interested Shareholder; or
  - (2) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions) to or with any Interested Shareholder or any Affiliate of any Interested Shareholder of any assets of the Corporation or any Subsidiary having an aggregate Fair Market Value of \$10,000,000 or more; or
  - (3) the issuance or transfer by the Corporation or any Subsidiary (in one transaction or a series of transactions) of any securities of the Corporation or any Subsidiary to any Interested Shareholder or any Affiliate of any Interested Shareholder in exchange for cash, securities or other property (or a combination thereof) having an aggregate Fair Market Value of \$10,000,000 or more; or
  - (4) the adoption of any plan or proposal for the liquidation or dissolution of the Corporation proposed by or on behalf of an Interested Shareholder or any Affiliate of any Interested Shareholder; or
  - (5) any reclassification of securities (including any reverse stock split), or recapitalization of the Corporation, or any merger or consolidation of the Corporation with any of its Subsidiaries or any other transaction (whether or not with or into or otherwise involving an Interested Shareholder) which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding shares of any class of equity or convertible securities of the Corporation or any Subsidiary which is directly or indirectly owned by any Interested Shareholder or any Affiliate of any Interested Shareholder;
- shall require the affirmative vote of the holders of at least 80% of the voting power of all of the shares of the Voting Stock, voting together as a single class. Such affirmative vote shall be required notwithstanding the fact that no vote may be required or that the vote of a lower percentage may be specified, by law or in any agreement with any national securities exchange or otherwise. The term "Business Combination" as used in this Article EIGHTH shall mean any transaction which is referred to in any one or more of paragraphs (1) through (5) of this subdivision (a).
- (b) The provisions of subdivision (a) of this Article EIGHTH shall not be applicable to any particular Business Combination, and such Business Combination shall require only such affirmative vote, if any, as is required by law and any other provision of these Articles of Incorporation, if all of the conditions specified in either paragraph (1) or paragraph (2) below are met:
- (1) The Business Combination shall have been approved by a majority of the Continuing Directors (as hereinafter defined); or

- (2) All of the following conditions shall have been met:
- (A) The aggregate amount of the cash and the Fair Market Value (as hereinafter defined) as of the date of the consummation of the Business Combination of consideration other than cash to be received per share by holders of Common Stock in such Business Combination shall be at least equal to the highest of the following:
- (i) (if applicable) the highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the Interested Shareholder for any shares of Common Stock acquired by it (x) within the two-year period immediately prior to the date of the first public announcement of the proposal of the Business Combination (the "Announcement Date") or (y) in the transaction in which it became an Interested Shareholder, whichever is higher;
  - (ii) the Fair Market Value per share of Common Stock on the Announcement Date or on the date on which the Interested Shareholder became an Interested Shareholder (the "Determination Date"), whichever is higher; and
  - (iii) (if applicable) the price per share equal to the Fair Market Value per share of Common Stock determined pursuant to clause (A) (ii) above, multiplied by the ratio of (x) the highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the Interested Shareholder for any shares of Common Stock acquired by it within the two-year period immediately prior to the Announcement Date to (y) the Fair Market Value per share of Common Stock on the first day in such two-year period upon which the Interested Shareholder acquired any shares of Common Stock.
- (B) The aggregate amount of the cash and the Fair Market Value as of the date of the consummation of the Business Combination of consideration other than cash to be received per share by holders of shares of each class of outstanding Voting Stock (other than Common Stock and Institutional Voting Stock [as hereinafter defined]) shall be at least equal to the highest of the following (it being intended that the requirements of this subparagraph (B) shall be required to be met with respect to every class of outstanding Voting Stock (other than Institutional Voting Stock), whether or not the Interested Shareholder has previously acquired any shares of a particular class of Voting Stock):
- (i) (if applicable) the highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the Interested Shareholder for any shares of such class of Voting Stock acquired by it (x) within the two-year period immediately prior to the Announcement Date or (y) in the transaction in which it became an Interested Shareholder, whichever is higher;

- (ii) (if applicable) the highest preferential amount per share to which the holders of shares of such class of Voting Stock are entitled in the event of any voluntary or involuntary dissolution, liquidation or winding up of the Corporation;
  - (iii) the Fair Market Value per share of such class of Voting Stock on the Announcement Date or on the Determination Date, whichever is higher; and
  - (iv) (if applicable) the price per share equal to the Fair Market Value per share of such class of Voting Stock determined pursuant to clause (B)(iii) above, multiplied by the ratio of (x) the highest per share price (including any brokerage commissions, transfer taxes and soliciting dealers' fees) paid by the Interested Shareholder for any shares of such class of Voting Stock acquired by it within the two-year period immediately prior to the Announcement Date to (y) the Fair Market Value per share of such class of Voting Stock on the first day in such two-year period upon which the Interested Shareholder acquired any shares of such class of Voting Stock
- (C) The consideration to be received by holders of a particular class of outstanding Voting Stock (including Common Stock) shall be in cash or in the same form as the Interested Shareholder has previously paid for shares of such class of Voting Stock. If the Interested Shareholder has paid for shares of any class of Voting Stock with varying forms of consideration, the form of consideration for such class of Voting Stock shall be either cash or the form used to acquire the largest number of shares of such class of Voting Stock previously acquired by it.
- (D) After such Interested Shareholder has become an Interested Shareholder and prior to the consummation of such Business Combination:
- (i) except as approved by a majority of the Continuing Directors, there shall have been no failure to declare and pay at the regular date therefor full dividends (whether or not cumulative) on the outstanding shares of stock of all classes ranking prior as to dividends to the Common Stock;
  - (ii) there shall have been (x) no reduction in the annual rate of dividends paid on the Common Stock (except as necessary to reflect any subdivision of the Common Stock), except as approved by a majority of the Continuing Directors, and (y) an

increase in such annual rate of dividends as necessary to reflect any reclassification (including any reverse stock split), recapitalization, reorganization or any similar transaction which has the effect of reducing the number of outstanding shares of the Common Stock, unless the failure to so increase such annual rate is approved by a majority of the Continuing Directors; and

- (iii) such Interested Shareholder shall not have become the beneficial owner of any additional shares of Voting Stock except as part of the transaction which results in such Interested Shareholder becoming an Interested Shareholder.
- (E) After such Interested Shareholder has become an Interested Shareholder, such Interested Shareholder shall not have received the benefit, directly or indirectly (except proportionately as a shareholder), of any loans, advances, guarantees, pledges or other financial assistance or any tax credits or other tax advantages provided by the Corporation, whether in anticipation of or in connection with such Business Combination or otherwise.
- (F) A proxy or information statement describing the proposed Business Combination and complying with the requirements of the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder (or any subsequent provisions replacing such Act, rules or regulations) shall be mailed to shareholders of the Corporation at least 30 days prior to the consummation of such Business Combination (whether or not such proxy or information statement is required to be mailed pursuant to such Act or subsequent provisions).

(c) For the purposes of this Article EIGHTH:

The terms "Affiliate" and "Associate" have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as in effect on January 1, 1987.

A person shall be deemed to be a "beneficial owner" of any Voting Stock:

- (i) which such person or any of its Affiliates or Associates beneficially owns, directly or indirectly, or;
- (ii) which such person or any of its Affiliates or Associates has (a) the right to acquire (whether such right is exercisable immediately or only after the passage of time), pursuant to any agreement, arrangement or understanding or upon the exercise of conversion rights, exchange rights, warrants or options, or otherwise, or (b) the right to vote pursuant to any agreement, arrangement or understanding; or
- (iii) which is beneficially owned, directly or indirectly, by any other person with which such person or any of its Affiliates or Associates has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of any shares of Voting Stock.

For the purposes of determining whether a person is an Interested Shareholder the number of shares of Voting Stock deemed to be outstanding shall include all shares of which such person is the beneficial owner in accordance with the foregoing definition but shall not include any other shares of Voting Stock which may be issuable pursuant to any agreement, arrangement or understanding, or upon exercise of conversion rights, warrants or options, or otherwise.

The term "Continuing Director" means any member of the Board of Directors of the Corporation who is unaffiliated with the Interested Shareholder and was a member of the Board of Directors prior to the time that the Interested Shareholder became an Interested Shareholder, and any successor of a Continuing Director who is unaffiliated with the Interested Shareholder and is recommended to succeed a Continuing Director by a majority of Continuing Directors then on the Board of Directors.

The term "Fair Market Value" means (i) in the case of stock, the highest closing sale price during the 30-day period immediately preceding the date in question of a share of such stock on the Composite Tape for New York Stock Exchange-Listed Stocks, or, if such stock is not quoted on the Composite Tape, on the New York Stock Exchange, or, if such stock is not listed on such Exchange, on the principal United States securities exchange registered under the Securities Exchange Act of 1934, as amended, on which such stock is listed, or, if such stock is not listed on any such exchange, the highest closing bid quotation with respect to a share of such stock during the 30-day period preceding the date in question on the National Association of Securities Dealers, Inc. Automated Quotations System or any system then in use, or if no such quotations are available, the fair market value on the date in question of a share of such stock as determined by the Continuing Directors in good faith; and (ii) in the case of property other than cash or stock, the fair market value of such property on the date in question as determined by a majority of the Continuing Directors in good faith.

The term "Interested Shareholder" shall mean any person (other than the Corporation or any Subsidiary) who or which:

- (i) is the beneficial owner, directly or indirectly, of more than 10% of the voting power of the outstanding Voting Stock; or
- (ii) is an Affiliate of the Corporation and at any time within the two-year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding Voting Stock; or
- (iii) is an assignee of or has otherwise succeeded to any shares of Voting Stock which were at any time within the two-year period immediately prior to the date in question beneficially owned by any Interested Shareholder, if such assignment or succession shall have occurred in the course of a transaction or series of transactions not involving a public offering within the meaning of the Securities Act of 1933, as amended.

The term "Institutional Voting Stock" shall mean any class of Voting Stock which was issued to and continues to be held solely by one or more insurance companies, pension funds, commercial banks, savings banks or similar financial institutions or institutional investors.

The term "person" shall mean any individual, firm, corporation or other entity.

The term "Subsidiary" shall mean any corporation of which a majority of any class of equity security is owned, directly or indirectly, by the corporation; *provided, however*, that for the purposes of

the definition of Interested Shareholder set forth above, the term “Subsidiary” shall mean only a corporation of which a majority of each class of equity security is owned, directly or indirectly, by the Corporation.

The term “Voting Stock” has the meaning ascribed to such term in Article FIFTH.

In the event of any Business Combination in which the Corporation survives, the phrase “consideration other than cash to be received” as used in paragraphs 2(A) and 2(B) of subdivision (b) of this Article EIGHTH shall include the shares of Common Stock and/or the shares of any other class of outstanding Voting Stock retained by the holders of such shares.

- (d) The Directors of the Corporation shall have the power and duty to determine for the purposes of this Article EIGHTH, on the basis of information known to them after reasonable inquiry, (A) whether a person is an Interested Shareholder, (B) the number of shares of Voting Stock beneficially owned by any person, (C) whether a person is an Affiliate or Associate of another person, (D) whether a class of Voting Stock is Institutional Voting Stock, and (E) whether the assets which are the subject of any Business Combination have, or the consideration to be received for the issuance or transfer of securities by the Corporation or any Subsidiary in any Business Combination has, an aggregate Fair Market Value of \$10,000,000 or more.

Nothing contained in this Article EIGHTH shall be construed to relieve any Interested Shareholder from any fiduciary obligation imposed by law.

Notwithstanding anything contained in these Articles of Incorporation to the contrary, the provisions of this Article EIGHTH shall not be altered, amended or repealed, and no provision inconsistent therewith shall be included in these Articles of Incorporation or the Bylaws of the Corporation, without the affirmative vote of the holders of at least eighty percent (80%) of the voting power of all of the shares of the Voting Stock, voting together as a single class.

IN WITNESS WHEREOF, we have set our hands and seals under these presents, this 29<sup>th</sup> day of May 2012.

/s/ Scott L. Morris

Scott L. Morris, *Chairman of the Board, President and Chief Executive Officer*

ATTEST:

/s/ Karen S. Feltes

Karen S. Feltes, *Senior Vice President and Corporate Secretary*

(SEAL)

**CERTIFICATE**

The undersigned officers of Avista Corporation, being first duly sworn on oath, depose and say:

- (a) That they have been authorized to execute the within Restated Articles of Incorporation by resolution of the Board of Directors adopted on the 3<sup>rd</sup> day of February 2012; and
- (b) That Subdivision (l) of Article THIRD and Article SEVENTH of these Restated Articles of Incorporation correctly set forth the text of the amendments approved by the shareholders on the 10<sup>th</sup> of May 2012 in accordance with the provisions of RCW 23B.10.030 and 23B.10.040, such amendments being set forth in Exhibit A to this certificate; and
- (c) That these Restated Articles of Incorporation correctly set forth the text of the Articles of Incorporation as heretofore amended and as further amended by the amendments approved by the shareholders referred to under clause (b) above, and, except as indicated under clause (b) above, no shareholder action is required for these Restated Articles of Incorporation; and
- (d) That these Restated Articles of Incorporation supersede the original Articles of Incorporation and all amendments thereto and restatements thereof.

/s/ Scott L. Morris  
 \_\_\_\_\_  
 Scott L. Morris, *Chairman of the Board, President and Chief Executive Officer*

/s/ Karen S. Feltes  
 \_\_\_\_\_  
 Karen S. Feltes, *Senior Vice President and Corporate Secretary*

State of Washington        )  
                                       ) ss.:  
 County of Spokane         )

I certify that I know or have satisfactory evidence that Scott L. Morris and Karen S. Feltes are the persons who appeared before me, and each of said persons acknowledged that he or she signed this instrument, on oath stated that he or she was authorized to execute this instrument and acknowledged it as an executive officer of Avista Corporation to be the free and voluntary act of Avista Corporation for the uses and purposes mentioned in this instrument.

Dated: May 29, 2012

(SEAL)

/s/ Rae An Cornell  
 \_\_\_\_\_  
 Notary Public  
  
 RAE AN CORNELL  
 Notary Public  
 State of Washington  
 Commission Expires January 29, 2014

**AMENDMENTS TO  
RESTATED ARTICLES OF INCORPORATION OF  
AVISTA CORPORATION**

The amendments and restatements of specified provisions of the Restated Articles of Incorporation approved by the shareholders on May 10, 2012 are set forth below. Text stricken through indicates deletions, and text in italics indicates additions.

**Article THIRD**

Subdivision (l) of Article THIRD, which relates to the authorization of new classes of capital stock senior to the common stock, would be amended and restated as set forth below:

Subject to the limitations set forth in subdivision (j) of this Article THIRD (and subject to the rights of any class of stock hereafter authorized), and except as may be otherwise provided by law, upon the vote of a majority of all of the Directors of the Corporation and of the holders of record of ~~two-thirds a~~ *majority* of the total number of shares of the Corporation then issued and outstanding and entitled to vote (or, if the vote of a larger number or different proportion of shares is required by the laws of the state of Washington, notwithstanding the above agreement of the shareholders of the Corporation to the contrary, then upon the vote of the holders of record of the larger number or different proportion of shares so required) the Corporation may from time to time create or authorize one or more other classes of stock with such preferences, designations, rights, privileges, powers, restrictions, limitations and qualifications as may be determined by said vote, which may be the same or different from the preferences, designations, rights, privileges, powers, restrictions, limitations and qualifications of the classes of stock of the Corporation then authorized and/or the Corporation may increase or decrease the number of shares of one or more of the classes of stock then authorized.

**Article SEVENTH**

The eighth, ninth and tenth paragraphs of Article SEVENTH, which relates, among other things, to sales of assets and mergers, would be deleted:

~~Any property of the Corporation not essential to the conduct of its corporate business may be sold, leased, exchanged, or otherwise disposed of, by authority of its Board of Directors and the Corporation may sell, lease, exchange or otherwise dispose of, all of its property and franchises, or any of its property, franchises, corporate rights, or privileges, essential to the conduct of its corporate business and purposes upon the consent of and for such consideration and upon such terms as may be authorized by a majority of all of the Directors and the holders of two-thirds of the issued and outstanding shares of the Corporation having voting power (or, if the consent or vote of a larger number or different proportion of the Directors and/or shares is required by the laws of the state of Washington, notwithstanding the above agreement of the shareholders of the Corporation to the~~

contrary, then upon the consent or vote of the larger number or different proportion of the Directors and/or shares so required) expressed in writing, or by vote at a meeting of holders of the shares of the Corporation having voting power duly held as provided by law, or in the manner provided by the Bylaws of the Corporation, if not inconsistent therewith.

Upon the affirmative vote of the holders of two thirds of the issued and outstanding shares of the Corporation having voting power given at a meeting of the holders of the shares of the Corporation having voting power duly called for that purpose or when authorized by the written consent of the holders of two thirds of the issued and outstanding shares of the Corporation having voting power and upon the vote of a majority of the Board of Directors, all of the property, franchises, rights and assets of the Corporation may be sold, conveyed, assigned and transferred as an entirety to a new company to be organized under the laws of the United States, the state of Washington or any other state of the United States, for the purpose of so taking over all the property, franchises, rights and assets of the Corporation, with the same or a different authorized number of shares of stock and with the same preferences, voting powers, restrictions and qualifications thereof as may then attach to the classes of stock of the Corporation then outstanding so far as the same shall be consistent with such laws of the United States or of Washington or of such other state (provided that the whole or any part of such stock or of any class thereof may be stock with or without a nominal or par value), the consideration for such sale and conveyance to be the assumption by such new company of all of the then outstanding liabilities of the Corporation and the issuance and delivery by the new company of shares of stock (any or all thereof either with or without nominal or par value) of such new company of the several classes into which the stock of the Corporation is then divided equal in number to the number of shares of stock of the Corporation of said several classes then outstanding. In the event of such sale, each holder of stock of the Corporation agrees so far as he may be permitted by the laws of Washington forthwith to surrender for cancellation his certificate or certificates for stock of the Corporation and to receive and accept in exchange therefor, as his full and final distributive share of the proceeds of such sale and conveyance and of the assets of the Corporation, a number of shares of the stock of the new company of the class corresponding to the class of the shares surrendered equal in number to the shares of stock of the Corporation so surrendered, and in such event no holder of any of the stock of the Corporation shall have any rights or interests in or against the Corporation, except the right upon surrender of his certificate as aforesaid properly endorsed, to receive from the Corporation certificates for such shares of said new company as herein provided. Such new company may have all or any of the powers of the Corporation and the certificate of incorporation and bylaws of such new company may contain all or any of the provisions contained in the Articles of Incorporation and Bylaws of the Corporation.

Upon the written assent, in person or by proxy, or pursuant to the affirmative vote, in person or by proxy, of the holders of a majority in number of the shares then outstanding and entitled to vote (or, if the assent or vote of a larger number

~~or different proportion of shares is required by the laws of the state of Washington notwithstanding the above agreement of the shareholders of the Corporation to the contrary, then upon the assent or vote of the larger number or different proportion of the shares so required) (1) any or every statute of the state of Washington hereafter enacted, whereby the rights, powers or privileges of the Corporation are or may be increased, diminished, or in any way affected, or whereby the rights, powers or privileges of the shareholders of corporations organized under the law under which the Corporation is organized are increased, diminished or in any way affected or whereby effect is given to the action taken by any part less than all of the shareholders of any such corporation shall, notwithstanding any provision which may at the time be contained in these Articles of Incorporation or any law, apply to the Corporation, and shall be binding not only upon the Corporation but upon every shareholder thereof, to the same extent as if such statute had been in force at the date of the making and filing of these Articles of Incorporation and/or (2) amendments to said Articles authorized at the time of the making of such amendments by the laws of the state of Washington may be made. provided, however, that (a) the provisions of Article THIRD hereof limiting the preemptive rights of shareholders, requiring majority voting in the election of Directors and regarding entry in the capital stock account of consideration received upon the sale of shares of capital stock without nominal or par value and all of the provisions of Article FIFTH hereof shall not be altered, amended, repealed, waived or changed in any way, unless the holders of record of at least two-thirds of the number of shares entitled to vote then outstanding shall consent thereto in writing or affirmatively vote therefor in person or by proxy at a meeting of shareholders at which such change is duly considered.~~

The following paragraph would be inserted after the stricken text, shown above, in Article SEVENTH:

*In any circumstance in which Washington law would require the approval of shareholders to authorize (1) the merger of the Corporation with or into another entity or a statutory share exchange with another entity, (2) a sale, lease, exchange or other disposition of property of the Corporation or (3) the dissolution of the Corporation, the requisite shareholder approval shall be the affirmative vote of the holders of a majority of the outstanding shares of capital stock entitled to vote on such transaction, unless Washington law shall require a higher standard.*

## AVISTA CORPORATION

Computation of Ratio of Earnings to Fixed Charges  
Consolidated  
(Thousands of Dollars)

	Six months ended June 30, 2012	Years Ended December 31				
		2011	2010	2009	2008	2007
<b>Fixed charges, as defined:</b>						
Interest charges	\$ 36,676	\$ 69,591	\$ 72,010	\$ 61,361	\$ 74,914	\$ 80,095
Amortization of debt expense and premium - net	1,926	4,617	4,414	5,673	4,673	6,345
Interest portion of rentals	1,172	2,154	2,027	1,874	1,601	1,612
<b>Total fixed charges</b>	<b>\$ 39,774</b>	<b>\$ 76,362</b>	<b>\$ 78,451</b>	<b>\$ 68,908</b>	<b>\$ 81,188</b>	<b>\$ 88,052</b>
<b>Earnings, as defined:</b>						
Pre-tax income from continuing operations	\$ 88,243	\$ 160,171	\$ 146,105	\$ 134,971	\$ 120,382	\$ 63,061
Add (deduct):						
Capitalized interest	(1,121)	(2,942)	(298)	(545)	(4,612)	(3,864)
Total fixed charges above	39,774	76,362	78,451	68,908	81,188	88,052
<b>Total earnings</b>	<b>\$ 126,896</b>	<b>\$ 233,591</b>	<b>\$ 224,258</b>	<b>\$ 203,334</b>	<b>\$ 196,958</b>	<b>\$ 147,249</b>
Ratio of earnings to fixed charges	3.19	3.06	2.86	2.95	2.43	1.67

Avista Corporation  
Spokane, Washington

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of Avista Corporation and subsidiaries for the periods ended June 30, 2012 and 2011, as indicated in our report dated August 7, 2012; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, is incorporated by reference in Registration Statement Nos. 2-81697, 2-94816, 033-54791, 333-03601, 333-22373, 333-33790, 333-47290, 333-126577, and 333-179042 on Form S-8; and in Registration Statement Nos. 333-163609 and 333-177981 on Form S-3.

We are also aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ Deloitte & Touche LLP

Seattle, Washington  
August 7, 2012

**CERTIFICATION**

I, Scott L. Morris, certify that:

1. I have reviewed this 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 7, 2012

/s/ Scott L. Morris

---

Scott L. Morris  
Chairman of the Board, President  
and Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION**

I, Mark T. Thies, certify that:

1. I have reviewed this 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 7, 2012

/s/ Mark T. Thies

---

Mark T. Thies  
Senior Vice President and  
Chief Financial Officer  
(Principal Financial Officer)

**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, Scott L. Morris, Chairman of the Board, President and Chief Executive Officer of Avista Corporation (the "Company"), and Mark T. Thies, Senior Vice President and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 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 7, 2012

/s/ Scott L. Morris

\_\_\_\_\_  
Scott L. Morris  
Chairman of the Board, President  
and Chief Executive Officer

/s/ Mark T. Thies

\_\_\_\_\_  
Mark T. Thies  
Senior Vice President and  
Chief Financial Officer