

AVISTA CORP  
Form 10-Q  
November 07, 2013

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 September 30, 2013 OR

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

FOR THE TRANSITION PERIOD FROM TO  
Commission file number 1-3701

AVISTA CORPORATION  
(Exact name of Registrant as specified in its charter)

Washington 91-0462470  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1411 East Mission Avenue, Spokane, Washington 99202-2600  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 509-489-0500

Web site: <http://www.avistacorp.com>

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes  No

Indicate by check mark whether the registrant 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 October 31, 2013, 60,036,179 shares of Registrant's Common Stock, no par value (the only class of common stock), were outstanding.

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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;
- business environment; 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) which affect energy demand and electric generation, including the effect of precipitation and temperature on hydroelectric resources, the effect of wind patterns on wind-generated power, weather-sensitive customer demand, and similar impacts on supply and demand in the wholesale energy markets;
- state and federal regulatory decisions that affect our ability to recover costs and earn a reasonable return including, but not limited to, disallowance or delay in the recovery of capital investments and operating costs;
- changes in wholesale energy prices that can affect operating income, cash requirements to purchase electricity and natural gas, value received for wholesale sales, 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 customer demand for utility services;
- the effect of increased customer energy efficiency;
- 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 and the global economy;
- the potential effects of legislation or administrative rulemaking, including possible effects on our generating resources of 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 and other postretirement medical plans, which can affect future funding obligations, pension and other postretirement medical expense and pension and other postretirement medical 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;
- 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;
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changes in, and compliance with, environmental and endangered species laws, regulations, decisions and policies, including present and potential environmental remediation costs;

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wholesale and retail competition including alternative energy sources, emerging customer-owned power resource technologies, suppliers and delivery arrangements and the extent that new uses for our services may materialize; the ability to comply with the terms of the licenses for our hydroelectric generating facilities at cost-effective levels; severe weather or 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, mechanical breakdowns, or other incidents that may cause unplanned outages at any of our generation facilities, transmission and distribution systems or other operations; public injuries or damages arising from or allegedly arising from our operations; blackouts or disruptions of interconnected transmission systems (the regional power grid); disruption to information systems, automated controls and other technologies that we rely on for our operations, communications and customer service; terrorist attacks, cyber attacks or other malicious acts that may disrupt or cause damage to our utility assets or to the national economy in general, including any effects of terrorism, cyber 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 obstacles that impede our ability to complete such projects timely and effectively; changes in the long-term global and Pacific Northwest climates, 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 changes in demand by 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; potential decline in our credit ratings, with effects including impeded access to capital markets, higher interest costs, and certain ratings trigger covenants 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 or 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 litigation or 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

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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.

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## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Three Months Ended September 30

Dollars in thousands, except per share amounts

(Unaudited)

	2013	2012
Operating Revenues:		
Utility revenues	\$278,473	\$292,085
Ecova revenues	46,398	38,617
Other non-utility revenues	11,004	9,930
Total operating revenues	335,875	340,632
Operating Expenses:		
Utility operating expenses:		
Resource costs	131,136	153,801
Other operating expenses	69,596	66,456
Depreciation and amortization	29,823	28,255
Taxes other than income taxes	18,712	18,122
Ecova operating expenses:		
Other operating expenses	37,047	33,868
Depreciation and amortization	3,909	3,260
Other non-utility operating expenses:		
Other operating expenses	10,212	10,131
Depreciation and amortization	171	131
Total operating expenses	300,606	314,024
Income from operations	35,269	26,608
Interest expense	19,566	19,128
Interest expense to affiliated trusts	117	136
Capitalized interest	(820)	(644)
Other (income) expense-net	(984)	418
Income before income taxes	17,390	7,570
Income tax expense	5,459	1,608
Net income	11,931	5,962
Net income attributable to noncontrolling interests	(518)	(176)
Net income attributable to Avista Corporation shareholders	\$11,413	\$5,786
Weighted-average common shares outstanding (thousands), basic	59,994	59,047
Weighted-average common shares outstanding (thousands), diluted	60,032	59,123
Earnings per common share attributable to Avista Corporation shareholders:		
Basic	\$0.19	\$0.10
Diluted	\$0.19	\$0.10
Dividends paid per common share	\$0.305	\$0.29

The Accompanying Notes are an Integral Part of These Statements.



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## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands, except per share amounts

(Unaudited)

	2013	2012
Operating Revenues:		
Utility revenues	\$ 1,007,319	\$ 990,860
Ecova revenues	133,365	115,707
Other non-utility revenues	30,145	29,907
Total operating revenues	1,170,829	1,136,474
Operating Expenses:		
Utility operating expenses:		
Resource costs	487,277	500,805
Other operating expenses	200,824	196,759
Depreciation and amortization	86,783	83,327
Taxes other than income taxes	66,137	63,723
Ecova operating expenses:		
Other operating expenses	110,753	104,392
Depreciation and amortization	11,474	9,455
Other non-utility operating expenses:		
Other operating expenses	28,972	28,480
Depreciation and amortization	536	511
Total operating expenses	992,756	987,452
Income from operations	178,073	149,022
Interest expense	59,119	57,453
Interest expense to affiliated trusts	352	413
Capitalized interest	(2,702)	(1,765)
Other income-net	(5,565)	(2,892)
Income before income taxes	126,869	95,813
Income tax expense	46,107	33,106
Net income	80,762	62,707
Net income attributable to noncontrolling interests	(1,351)	(355)
Net income attributable to Avista Corporation shareholders	\$ 79,411	\$ 62,352
Weighted-average common shares outstanding (thousands), basic	59,933	58,778
Weighted-average common shares outstanding (thousands), diluted	59,964	59,026
Earnings per common share attributable to Avista Corporation shareholders:		
Basic	\$ 1.32	\$ 1.06
Diluted	\$ 1.32	\$ 1.06
Dividends paid per common share	\$ 0.915	\$ 0.87

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Avista Corporation

For the Three Months Ended September 30

Dollars in thousands

(Unaudited)

	2013		2012
Net income	\$11,931		\$5,962
Other Comprehensive Income (Loss):			
Unrealized investment gains/(losses) - net of taxes of \$(233) and \$68, respectively	(395	)	110
Reclassification adjustment for realized gains on investment securities included in net income - net of taxes of \$(1) and \$(11), respectively	(1	)	(17
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$99 and \$90, respectively	184		168
Total other comprehensive income (loss)	(212	)	261
Comprehensive income	11,719		6,223
Comprehensive income attributable to noncontrolling interests	(518	)	(176
Comprehensive income attributable to Avista Corporation shareholders	\$11,201		\$6,047

For the Nine Months Ended September 30

Dollars in thousands

(Unaudited)

	2013		2012
Net income	\$80,762		\$62,707
Other Comprehensive Income (Loss):			
Unrealized investment gains/(losses) - net of taxes of \$(993) and \$244, respectively	(1,687	)	409
Reclassification adjustment for realized gains on investment securities included in net income - net of taxes of \$(8) and \$(94), respectively	(12	)	(158
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$297 and \$263, respectively	551		489
Total other comprehensive income (loss)	(1,148	)	740
Comprehensive income	79,614		63,447
Comprehensive income attributable to noncontrolling interests	(1,351	)	(355
Comprehensive income attributable to Avista Corporation shareholders	\$78,263		\$63,092

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED BALANCE SHEETS

Avista Corporation  
Dollars in thousands  
(Unaudited)

	September 30, 2013	December 31, 2012
Assets:		
Current Assets:		
Cash and cash equivalents	\$91,979	\$75,464
Accounts and notes receivable-less allowances of \$44,103 and \$44,155, respectively	139,512	193,683
Utility energy commodity derivative assets	3,430	4,139
Regulatory asset for utility derivatives	20,399	35,082
Investments and funds held for clients	92,870	88,272
Materials and supplies, fuel stock and natural gas stored	56,843	47,455
Deferred income taxes	28,740	34,281
Income taxes receivable	12,350	2,777
Other current assets	39,721	24,641
Total current assets	485,844	505,794
Net Utility Property:		
Utility plant in service	4,252,299	4,054,644
Construction work in progress	137,565	143,098
Total	4,389,864	4,197,742
Less: Accumulated depreciation and amortization	1,232,547	1,174,026
Total net utility property	3,157,317	3,023,716
Other Non-current Assets:		
Investment in exchange power-net	14,496	16,333
Investment in affiliated trusts	11,547	11,547
Goodwill	76,762	75,959
Intangible assets-net of accumulated amortization of \$33,886 and \$26,030, respectively	41,153	46,256
Long-term energy contract receivable of Spokane Energy	43,563	52,033
Other property and investments-net	66,486	46,542
Total other non-current assets	254,007	248,670
Deferred Charges:		
Regulatory assets for deferred income tax	67,691	79,406
Regulatory assets for pensions and other postretirement benefits	292,359	306,408
Other regulatory assets	105,608	103,946
Non-current utility energy commodity derivative assets	293	1,093
Non-current regulatory asset for utility derivatives	24,729	25,218
Other deferred charges	14,154	18,928
Total deferred charges	504,834	534,999
Total assets	\$4,402,002	\$4,313,179

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

Avista Corporation  
Dollars in thousands  
(Unaudited)

	September 30, 2013	December 31, 2012
Liabilities and Equity:		
Current Liabilities:		
Accounts payable	\$ 158,360	\$ 198,914
Client fund obligations	95,214	87,839
Current portion of long-term debt	50,330	50,372
Current portion of nonrecourse long-term debt of Spokane Energy	16,022	14,965
Short-term borrowings	66,000	52,000
Utility energy commodity derivative liabilities	18,708	29,515
Other current liabilities	145,602	142,544
Total current liabilities	550,236	576,149
Long-term debt	1,272,260	1,178,367
Nonrecourse long-term debt of Spokane Energy	5,666	17,838
Long-term debt to affiliated trusts	51,547	51,547
Long-term borrowings under committed line of credit	50,000	54,000
Regulatory liability for utility plant retirement costs	249,980	234,128
Pensions and other postretirement benefits	252,331	283,985
Deferred income taxes	528,981	524,877
Other non-current liabilities and deferred credits	122,214	110,215
Total liabilities	3,083,215	3,031,106
Commitments and Contingencies (See Notes to Condensed Consolidated Financial Statements)		
Redeemable Noncontrolling Interests	8,330	4,938
Equity:		
Avista Corporation Stockholders' Equity:		
Common stock, no par value; 200,000,000 shares authorized; 60,029,209 and 59,812,796 shares outstanding, respectively	898,199	889,237
Accumulated other comprehensive loss	(7,848	) (6,700
Retained earnings	399,053	376,940
Total Avista Corporation stockholders' equity	1,289,404	1,259,477
Noncontrolling Interests	21,053	17,658
Total equity	1,310,457	1,277,135
Total liabilities and equity	\$4,402,002	\$4,313,179

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands

(Unaudited)

	2013	2012	
Operating Activities:			
Net income	\$80,762	\$62,707	
Non-cash items included in net income:			
Depreciation and amortization	98,793	93,293	
Provision for deferred income taxes	16,512	18,380	
Power and natural gas cost amortizations (deferrals), net	(10,149	) 10,418	
Amortization of debt expense	2,841	2,876	
Amortization of investment in exchange power	1,838	1,838	
Stock-based compensation expense	4,718	4,539	
Equity-related AFUDC	(4,341	) (2,875	)
Pension and other postretirement benefit expense	31,894	29,785	
Amortization of Spokane Energy contract	8,470	7,786	
Write-off of Reardan wind generation capitalized costs	2,534	—	
Other	6,889	8,911	
Contributions to defined benefit pension plan	(44,000	) (44,000	)
Changes in working capital components:			
Accounts and notes receivable	50,681	61,106	
Materials and supplies, fuel stock and natural gas stored	(9,388	) 941	
Other current assets	(23,165	) 7,209	
Accounts payable	(23,756	) (10,783	)
Other current liabilities	11,269	5,277	
Net cash provided by operating activities	202,402	257,408	
Investing Activities:			
Utility property capital expenditures (excluding equity-related AFUDC)	(220,712	) (178,440	)
Other capital expenditures	(1,725	) (3,908	)
Federal grant payments received	2,631	5,902	
Cash paid by subsidiaries for acquisitions, net of cash received	—	(50,310	)
Decrease (increase) in funds held for clients	11,723	(9,599	)
Purchase of securities available for sale	(35,949	) (88,843	)
Sale and maturity of securities available for sale	16,955	103,545	
Other	(6,481	) (7,412	)
Net cash used in investing activities	(233,558	) (229,065	)

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands

(Unaudited)

	2013	2012
Financing Activities:		
Net increase in short-term borrowings	\$ 14,000	\$ 21,000
Borrowings from Ecova line of credit	3,000	28,000
Repayment of borrowings from Ecova line of credit	(7,000	) (5,000 )
Proceeds from issuance of long-term debt	90,000	—
Redemption and maturity of long-term debt	(415	) (11,363 )
Maturity of nonrecourse long-term debt of Spokane Energy	(11,115	) (10,153 )
Long-term debt and short-term borrowing issuance costs	(471	) (177 )
Cash received (paid) for settlement of interest rate swap agreements	2,901	(18,547 )
Issuance of common stock	4,479	28,699
Cash dividends paid	(54,963	) (51,215 )
Purchase of subsidiary noncontrolling interest	(379	) (917 )
Increase (decrease) in client fund obligations	7,375	(5,220 )
Issuance of subsidiary noncontrolling interest	—	3,714
Other	259	1,126
Net cash provided by (used in) financing activities	47,671	(20,053 )
Net increase in cash and cash equivalents	16,515	8,290
Cash and cash equivalents at beginning of period	75,464	74,662
Cash and cash equivalents at end of period	\$ 91,979	\$ 82,952
Supplemental Cash Flow Information:		
Cash paid during the period:		
Interest	\$ 45,633	\$ 43,487
Income taxes	33,522	12,527
Non-cash financing and investing activities:		
Accounts payable for capital expenditures	4,313	3,556
Valuation adjustment for redeemable noncontrolling interests	3,246	(8,274 )

The Accompanying Notes are an Integral Part of These Statements.

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## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY AND REDEEMABLE NONCONTROLLING INTERESTS

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands

(Unaudited)

	2013	2012
Common Stock, Shares:		
Shares outstanding at beginning of period	59,812,796	58,422,781
Issuance of common stock	216,413	1,332,089
Shares outstanding at end of period	60,029,209	59,754,870
Common Stock, Amount:		
Balance at beginning of period	\$ 889,237	\$ 855,188
Equity compensation expense	4,490	3,354
Issuance of common stock, net of issuance costs	4,479	28,699
Equity transactions of consolidated subsidiaries	(7	) 289
Balance at end of period	898,199	887,530
Accumulated Other Comprehensive Loss:		
Balance at beginning of period	(6,700	) (5,637
Other comprehensive income	(1,148	) 740
Balance at end of period	(7,848	) (4,897
Retained Earnings:		
Balance at beginning of period	376,940	336,150
Net income attributable to Avista Corporation shareholders	79,411	62,352
Cash dividends paid (common stock)	(54,963	) (51,215
Expiration of subsidiary noncontrolling interests redemption rights	—	23,805
Valuation adjustments and other noncontrolling interests activity	(2,335	) 6,019
Balance at end of period	399,053	377,111
Total Avista Corporation stockholders' equity	1,289,404	1,259,744
Noncontrolling Interests:		
Balance at beginning of period	17,658	174
Net income attributable to noncontrolling interests	1,232	234
Deconsolidation of variable interest entity	—	(673
Purchase of subsidiary noncontrolling interests	—	(117
Expiration of subsidiary noncontrolling interests redemption rights	—	17,790
Other	2,163	30
Balance at end of period	21,053	17,438
Total equity	\$ 1,310,457	\$ 1,277,182
Redeemable Noncontrolling Interests:		
Balance at beginning of period	\$ 4,938	\$ 51,809
Net income attributable to noncontrolling interests	119	121
Issuance of subsidiary noncontrolling interests	—	3,714
Purchase of subsidiary noncontrolling interests	(379	) (784
Expiration of subsidiary noncontrolling interests redemption rights	—	(41,595
Valuation adjustments and other noncontrolling interests activity	3,652	(6,539
Balance at end of period	\$ 8,330	\$ 6,726

The Accompanying Notes are an Integral Part of These Statements.





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## 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 September 30, 2013 and 2012 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, 2012 (2012 Form 10-K). Please refer to the section "Acronyms and Terms" in the 2012 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 Corporation 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, northern Idaho, and Montana. In addition, Avista Utilities has electric generating facilities in northern Oregon. Avista Utilities also provides natural gas distribution service in parts of eastern Washington and northern Idaho, as well as parts of northeastern and southwestern 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 78.9 percent owned subsidiary as of September 30, 2013. 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 nine months ended September 30 (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Utility taxes	\$10,901	\$10,741	\$41,045	\$41,353



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## Other (Income)/Expense-Net

Other (Income)/Expense-net consisted of the following items for the three and nine months ended September 30 (dollars in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Interest income	\$(124	) \$(166	) \$(620	) \$(804
Interest income on regulatory deferrals	(27	) (19	) (48	) (43
Equity-related AFUDC	(1,595	) (1,127	) (4,341	) (2,875
Net loss on investments	1,299	2,430	1,543	2,957
Other income	(537	) (700	) (2,099	) (2,127
Total	\$(984	) \$418	\$ (5,565	) \$ (2,892

## Materials and Supplies, Fuel Stock and Natural Gas Stored

Inventories of materials and supplies, fuel stock and natural gas stored are recorded at average cost for our regulated operations and the lower of cost or market for our non-regulated operations and consisted of the following as of September 30, 2013 and December 31, 2012 (dollars in thousands):

	September 30,	December 31,
	2013	2012
Materials and supplies	\$29,334	\$26,058
Fuel stock	3,750	4,121
Natural gas stored	23,759	17,276
Total	\$56,843	\$47,455

## 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, money market funds and investment securities classified as available for sale. Ecova does not invest the funds directly for the clients' benefit; therefore, Ecova bears the risk of loss associated with the investments. Investments and funds held for clients as of September 30, 2013 are as follows (dollars in thousands):

	Amortized	Unrealized	Fair Value
	Cost (1)	Gain (Loss)	
Cash and cash equivalents	\$14,155	\$—	\$14,155
Money market funds	3,238	—	3,238
Securities available for sale:			
U.S. government agency	68,631	(2,466	) 66,165
Municipal	3,529	13	3,542
Corporate fixed income – financial	3,000	4	3,004
Corporate fixed income – industrial	1,753	13	1,766
Certificates of deposit	1,000	—	1,000
Total securities available for sale	77,913	(2,436	) 75,477
Total investments and funds held for clients	\$95,306	\$ (2,436	) \$92,870



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## AVISTA CORPORATION

Investments and funds held for clients as of December 31, 2012 are as follows (dollars in thousands):

	Amortized Cost (1)	Unrealized Gain (Loss)	Fair Value
Cash and cash equivalents	\$ 13,867	\$ —	\$ 13,867
Money market funds	15,084	—	15,084
Securities available for sale:			
U.S. government agency	48,340	156	48,496
Municipal	820	28	848
Corporate fixed income – financial	5,010	16	5,026
Corporate fixed income – industrial	3,887	49	3,936
Certificates of deposit	1,000	15	1,015
Total securities available for sale	59,057	264	59,321
Total investments and funds held for clients	\$ 88,008	\$ 264	\$ 88,272

(1) Amortized cost represents the original purchase price of the investments, plus or minus any amortized purchase premiums or accreted purchase discounts.

Investments and funds held for clients are classified as a current asset since these funds are held for the purpose of satisfying the client fund obligations. As of September 30, 2013 and December 31, 2012 approximately 95 percent and 97 percent of the investment portfolio, respectively, was rated AA-, Aa3 and higher by nationally recognized statistical rating organizations. All fixed income securities were rated as investment grade as of September 30, 2013 and December 31, 2012.

Ecova reviews its investments continuously for indicators of other-than-temporary impairment. To make this determination, Ecova employs a methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of its investments. If the cost of an investment exceeds its fair value, Ecova evaluates, among other factors, general market conditions, credit quality of instrument issuers, the length of time and extent to which the fair value is less than cost, and whether it has plans to sell the security or it is more-likely-than not that Ecova will be required to sell the security before recovery. Ecova also considers specific adverse conditions related to the financial health of and specific prospects for the issuer as well as other cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in earnings and a new cost basis in the investment is established. Based on Ecova's analysis, securities available for sale do not meet the criteria for other-than-temporary impairment as of September 30, 2013 or December 31, 2012.

The following is a summary of the disposition of available-for-sale securities for the three and nine months ended September 30 (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Proceeds from sales, maturities and calls	\$ 1,825	\$ 32,053	\$ 16,955	\$ 103,545
Gross realized gains	2	111	20	252
Gross realized losses	—	—	—	—

Contractual maturities of securities available for sale as of September 30, 2013 and December 31, 2012 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
September 30, 2013	\$ 5,655	\$ 18,479	\$ 48,437	\$ 2,906	\$ 75,477
December 31, 2012	3,047	11,786	41,485	3,003	59,321

Actual maturities may differ due to call or prepayment rights and the effective maturity was 3.1 years as of September 30, 2013 and 1.9 years as of December 31, 2012.

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

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more frequently if impairment indicators arise. The Company completed its annual evaluation of goodwill for potential impairment as of December 31, 2012 for Ecova and as of November 30, 2012 for the other businesses 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, 2012	\$70,713	\$12,979	\$(7,733)	\$75,959
Adjustments	803	—	—	803
Balance as of September 30, 2013	\$71,516	\$12,979	\$(7,733)	\$76,762

Accumulated impairment losses are attributable to the other businesses. The adjustment to goodwill recorded represents a purchase accounting adjustment for Ecova's acquisition of LPB based upon final review of the fair market value of the noncontrolling interests associated with a portion of the LPB business and based on review of the fair market value of the client relationship intangible asset.

## Intangible Assets

Amortization expense related to Intangible Assets was as follows for the three and nine months ended September 30 (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Intangible asset amortization	\$2,765	\$2,436	\$8,442	\$7,091

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

	Remaining 2013	2014	2015	2016	2017
Estimated amortization expense	\$2,292	\$10,460	\$8,484	\$7,359	\$6,516

The gross carrying amount and accumulated amortization of Intangible Assets as of September 30, 2013 and December 31, 2012 are as follows (dollars in thousands):

	Estimated Useful Lives	September 30, 2013	December 31, 2012
Client backlog and relationships	2 - 12 years	\$33,559	\$32,059
Software development costs	3 - 7 years	38,148	33,990
Other	1 - 10 years	3,332	6,237
Total intangible assets		75,039	72,286
Client relationships accumulated amortization		(11,255)	(7,793)
Software development costs accumulated amortization		(20,383)	(16,557)
Other accumulated amortization		(2,248)	(1,680)
Total accumulated amortization		(33,886)	(26,030)
Total intangible assets - net		\$41,153	\$46,256

Of the total net intangible assets above, intangible assets associated with Ecova represent approximately \$40.4 million and \$45.4 million at September 30, 2013 and December 31, 2012, respectively.

## 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 any particular derivative depends on the intended use of that derivative and

the resulting designation.

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The Washington Utilities and Transportation Commission (UTC) 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 delivery. 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 delivery, 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.

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 delivered 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.

**Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss, net of tax, consisted of the following as of September 30, 2013 and December 31, 2012 (dollars in thousands):

	September 30, 2013	December 31, 2012
Unfunded benefit obligation for pensions and other postretirement benefit plans - net of taxes of \$(3,401) and \$(3,698), respectively	\$(6,316)	\$(6,867)
Unrealized gain (loss) on securities available for sale - net of taxes of \$(904) and \$97, respectively	(1,532)	167

Total accumulated other comprehensive loss \$(7,848 ) \$(6,700 )

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The following table details the reclassifications out of accumulated other comprehensive loss by component for the three and nine months ended September 30, 2013 (dollars in thousands):

Details about Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in Statement of Income
	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013	
Realized gains on investment securities	\$2	\$20	Other income-net
	2	20	Total before tax
	(1	) (8	) Tax expense
	\$1	\$12	Net of tax
Amortization of defined benefit pension items			
Amortization of net loss	\$(4,891	) \$(14,673	) (a)
Adjustment due to effects of regulation	4,608	13,825	(a)
	(283	) (848	) Total before tax
	99	297	Tax benefit
	\$(184	) \$(551	) Net of tax

(a) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost (see Note 6 for additional details).

**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.

**Voluntary Severance Incentive Program**

At December 31, 2012, the Company accrued total severance costs of \$7.3 million (pre-tax) related to the voluntary termination of 55 employees. The total severance costs were made up of the severance payments and the related payroll taxes and employee benefit costs. All terminations under the voluntary severance incentive program were completed by December 31, 2012. The cost of the program was recognized as expense during the fourth quarter of 2012 and severance pay was distributed in a single lump sum cash payment to each participant during January 2013. As of September 30, 2013, there was no remaining liability accrued.

**Correction of an Immaterial Error**

Subsequent to the issuance of the Company's condensed consolidated financial statements for the three and nine months ended September 30, 2012, the Company's management identified certain employee-related operating expenses, dues and donations, and other operating expenses totaling \$3.4 million and \$8.0 million for the three and nine months ended September 30, 2012, respectively, which had been erroneously included in "Other expense-net" in the previously issued financial statements rather than as a reduction to "Income from operations." Accordingly, such classification has been corrected in the accompanying Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2012 by including \$2.0 million and \$5.4 million of other operating expenses within utility operating expense, \$1.4 million and \$2.5 million of other operating expenses within other non-utility operating expenses and \$0.03 million and \$0.1 million of taxes other than income taxes within utility operating expenses, respectively. Such items had no effect on net income or earnings per share.

**Reclassifications**

Certain prior year amounts on the Company's Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows have been reclassified to conform to the current year presentation. In the

current year Condensed Consolidated Statements of Income, Ecova operating revenues and operating expenses have been reclassified to separate line items. Previously, such amounts had been classified within the line items captioned "Other non-utility revenues" and "Other non-utility operating expenses," respectively. Such items had no effect on net income or earnings per share. In the current year Condensed Consolidated Statements of Cash Flows, "Amortization of investment in exchange power," "Stock-based compensation expense," "Pension and other postretirement benefit expense" and "Amortization of Spokane Energy contract"

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have been added as their own line items. These were previously included in "Other" in the operating activities section.

**NOTE 2. NEW ACCOUNTING STANDARDS**

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." This ASU does not change current requirements for reporting net income or other comprehensive income in financial statements; however, it requires entities to disclose the effect on the line items of net income for reclassifications out of accumulated other comprehensive income if the item being reclassified is required to be reclassified in its entirety to net income under U.S. GAAP. For other items that are not required to be reclassified in their entirety to net income under U.S. GAAP, an entity is required to cross-reference other disclosures required under U.S. GAAP to provide additional detail about those items. The Company adopted this ASU effective January 1, 2013. The adoption of this ASU required additional disclosures in the Company's financial statements; however, it did not have any impact on the Company's financial condition, results of operations and cash flows.

In December 2011, the FASB issued ASU No. 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities." This ASU enhances disclosure requirements about the nature of an entity's right to offset and related arrangements associated with its financial instruments and derivative instruments. ASU No. 2011-11 requires the disclosure of the gross amounts subject to rights of set off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The Company adopted this ASU effective January 1, 2013. The adoption of this ASU required additional disclosures in the Company's financial statements; however, it did not have any impact on the Company's financial condition, results of operations and cash flows.

In January 2013, the FASB issued ASU No. 2013-01, "Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities." This ASU clarifies which instruments and transactions are subject to the enhanced disclosure requirements of ASU 2011-11 regarding the offsetting of financial assets and liabilities. ASU No. 2013-01 limits the scope of ASU No. 2011-11 to only recognized derivative instruments, repurchase agreements and reverse repurchase agreements, and borrowing and lending securities transactions that are offset in accordance with either Accounting Standards Codification (ASC) 210-20-45 or ASC 815-10-45. The Company adopted this ASU effective January 1, 2013. The adoption of this ASU did not have any impact on the Company's financial condition, results of operations and cash flows.

**NOTE 3. VARIABLE INTEREST ENTITIES**

**Lancaster Power Purchase Agreement**

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 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 \$303 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.

Palouse Wind Power Purchase Agreement

In June 2011, the Company entered into a 30-year PPA with Palouse Wind, LLC (Palouse Wind), an affiliate of First Wind Holdings, LLC. The PPA relates to a wind project that was developed by Palouse Wind in Whitman County, Washington and under the terms of the PPA, the Company acquires all of the power and renewable attributes produced by the wind project for a fixed price per MWh, which escalates annually, without consideration for market fluctuations. The wind project has a

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nameplate capacity of approximately 105 MW and is expected to produce approximately 40 aMW annually. The project was completed and energy deliveries began during the fourth quarter of 2012. Under the PPA, the Company has an annual option to purchase the wind project following the 10<sup>th</sup> anniversary of the commercial operation date at a fixed price determined under the contract.

The Company evaluated this agreement to determine if it has a variable interest which must be consolidated. Based on its analysis, Avista Corp. does not consider itself to be the primary beneficiary of the Palouse Wind facility due to the fact that it pays a fixed price per MWh, which represents the only financial obligation, and does not have any input into the management of the day-to-day operations of the facility. Accordingly, Palouse Wind is not included in Avista Corp.'s condensed consolidated financial statements. The Company has a future contractual obligation of approximately \$562 million under the PPA (representing the charges associated with purchasing the energy and renewable attributes through 2042) and believes this would be its maximum exposure to loss. However, the Company believes that such costs will be recovered through retail rates.

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

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 which is in March of each year. Stock options and other outstanding redeemable stock are valued at their maximum redemption amount which is equal to their intrinsic value (fair value less exercise price).

The following details redeemable noncontrolling interests as of September 30, 2013 and December 31, 2012 (dollars in thousands):

	September 30, 2013	December 31, 2012
Stock options and other outstanding redeemable stock	\$8,330	\$4,938

On January 31, 2012, Ecova acquired all of the capital stock of 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 the 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. The results of operations of LPB are included in the condensed consolidated financial statements beginning February 1, 2012. The sellers of LPB did not receive additional purchase price payments in 2012 and will not receive additional payments in 2013; however, they have the potential to receive additional purchase price payments of \$1.5 million in 2014. These payments are contingent upon reaching certain revenue thresholds for certain customer contracts. As of September 30, 2013, Ecova has recorded a contingent liability of \$0.2 million based on management's assessment of the probability of the revenue thresholds being achieved.

Pro forma disclosures reflecting the effects of Ecova's acquisition are not presented, as the acquisition is not material to Avista Corp.'s condensed consolidated financial condition or 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 our resource procurement and management operations in the electric business, we engage in an ongoing process of resource optimization, which involves the economic selection from available energy resources to serve our load obligations and the use of these resources to capture available economic value. We transact in wholesale markets by selling and purchasing electric capacity and energy, fuel for electric generation, and derivative contracts related to capacity, energy and fuel. Such transactions are part of the process of matching resources with our load obligations and hedging the related financial risks. These transactions range from terms of intra-hour up to multiple years.



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Avista Utilities makes continuing projections of:

- electric loads at various points in time (ranging from intra-hour 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, we make purchases and sales of electric capacity and energy, fuel for electric generation, and related derivative instruments to match expected resources to expected electric load requirements and reduce our exposure to electricity (or fuel) market price changes. 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. Transactions include both physical energy contracts and related derivative instruments.

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.

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 September 30, 2013 that are expected to be delivered in each respective year (in thousands of MWhs and mmbTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical (1) MWH	Financial (1) MWH	Physical (1) mmbTUs	Financial (1) mmbTUs	Physical MWH	Financial MWH	Physical mmbTUs	Financial mmbTUs
2013	385	997	11,576	36,932	230	1,123	906	26,934
2014	702	1,942	22,613	115,004	345	2,839	1,786	84,108
2015	379	1,013	4,523	72,320	254	2,542	—	46,840
2016	367	—	2,505	38,210	287	1,634	—	13,380
2017	366	—	675	—	286	—	—	—
Thereafter	583	—	—	—	443	—	—	—

(1) Physical transactions represent commodity transactions where Avista Utilities will take delivery of either electricity or natural gas and financial transactions represent derivative instruments with no physical delivery, such

as futures, swaps or options.

The above electric and natural gas derivative contracts will be included in either power supply costs or natural gas supply costs during the period they are delivered and will be included in the various recovery mechanisms (ERM, PCA, and PGAs), or in the general rate case process, and are expected to be collected through retail rates from customers.

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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 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 September 30, 2013 and December 31, 2012 (dollars in thousands):

Septembe