AVISTA CORP
Form 10-K
February 27, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM ______ TO ______

Commission file number 1-3701

AVISTA CORPORATION

(Exact name of Registrant as specified in its charter)

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	**Name of Each Exchange on Which Registered**
Common Stock, no par value, together with Preferred Share Purchase Rights appurtenant thereto	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
Preferred Stock, Cumulative, Without Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act . Yes ¨ No x

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 x	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 x

The aggregate market value of the Registrant s outstanding Common Stock, no par value (the only class of voting stock), held by non-affiliates is $1,148,013,859 based on the last reported sale price thereof on the consolidated tape on June 30, 2008.

As of January 31, 2009, 54,629,586 shares of Registrant s Common Stock, no par value (the only class of common stock), were outstanding.

Documents Incorporated By Reference

Document	Part of Form 10-K into Which Document is Incorporated
Proxy Statement to be filed in connection with the annual meeting of shareholders to be held May 7, 2009	**Part III, Items 10, 11, 12, 13 and 14**

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* = not an applicable item in the 2008 calendar year for the Company

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ACRONYMS AND TERMS

(The following acronyms and terms are found in multiple locations within the document)

Acronym/Term	**Meaning**
aMW	- Average Megawatt - a measure of the average rate at which a particular generating source produces energy over a period of time
AFUDC	- Allowance for Funds Used During Construction; represents the cost of both the debt and equity funds used to finance utility plant additions during the construction period
AM&D	- Advanced Manufacturing and Development, does business as METALfx
APB	- Accounting Principles Board
Advantage IQ	- Advantage IQ, Inc., provider of facility information and cost management services for multi-site customers throughout North America, subsidiary of Avista Capital
Avista Capital	- Parent company to the Company s non-utility businesses
Avista Corp.	- Avista Corporation, the Company
Avista Energy	- Avista Energy, Inc., an electricity and natural gas marketing, trading and resource management business, subsidiary of Avista Capital
Avista Utilities	- operating division of Avista Corp. comprising the regulated utility operations
BPA	- Bonneville Power Administration
Capacity	- the rate at which a particular generating source is capable of producing energy, measured in KW or MW
Cabinet Gorge	- the Cabinet Gorge Hydroelectric Generating Project, located on the Clark Fork River in Idaho
Colstrip	- the coal-fired Colstrip Generating Plant in southeastern Montana
Coyote Springs 2	- the natural gas-fired Coyote Springs 2 Generating Plant located near Boardman, Oregon
CT	- Combustion turbine
Deadband or ERM deadband	- the first $4.0 million in annual power supply costs above or below the amount included in base retail rates in Washington under the Energy Recovery Mechanism in the state of Washington.
Dekatherm	- Unit of measurement for natural gas; a dekatherm is equal to approximately one thousand cubic feet (volume) or 1,000,000 BTUs (energy)
DOE	- the state of Washington s Department of Ecology
Energy	- the amount of electricity produced or consumed over a period of time, measured in KWH or MWH
EITF	- Emerging Issues Task Force
ERM	- the Energy Recovery Mechanism in the state of Washington

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FASB	- Financial Accounting Standards Board
FIN	- Financial Accounting Standards Board Interpretation
FERC	- Federal Energy Regulatory Commission
IPUC	- Idaho Public Utilities Commission
Jackson Prairie	- Jackson Prairie Natural Gas Storage Project, an underground natural gas storage field located near Chehalis, Washington
KV	- Kilovolt or 1000 volts, a measure of capacity on transmission lines
KW, KWH	- Kilowatt or 1000 watts a measure of generating output, kilowatt-hour or 1000 watt hours a measure of energy produced
Lancaster Plant	- a natural gas-fired combined cycle combustion turbine plant located in Idaho
MW, MWH	- Megawatt or 1000 KW, megawatt-hour or 1000 KWH
NERC	- North American Electricity Reliability Council
Noxon Rapids	- the Noxon Rapids Hydroelectric Generating Project, located on the Clark Fork River in Montana
OASIS	- Open Access Same-Time Information System
OPUC	- The Public Utility Commission of Oregon
PCA	- the Power Cost Adjustment mechanism in the state of Idaho
PLP	- Potentially liable party
PUD	- Public Utility District
PURPA	- the Public Utility Regulatory Policies Act of 1978
RTO	- Regional Transmission Organization
SFAS	- Statement of Financial Accounting Standards
Spokane River Project	- the five hydroelectric plants operating under one FERC license on the Spokane River (Long Lake, Nine Mile, Upper Falls, Monroe Street and Post Falls)
Therm	- Unit of measurement for natural gas; a therm is equal to approximately one hundred cubic feet (volume) or 100,000 BTUs (energy)
Watt	- Unit of measurement for electricity; a watt is equal to the rate of work represented by a current of one ampere under a pressure of one volt
WUTC	- Washington Utilities and Transportation Commission

AVISTA CORPORATION

PART I

Our Annual Report on Form 10-K contains forward-looking statements, which should be read with the cautionary statements and important factors included at Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Forward-Looking Statements on pages 24-25. 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, predicts, and similar expressions. Forward-looking statements are subject to a variety of risks and uncertainties and other factors. Many of these factors are beyond our control and could have a significant effect on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in our statements.

Available Information

Our Web site address is www.avistacorp.com. We make annual, quarterly and current reports available at our Web site as soon as practicable after electronically filing these reports with the Securities and Exchange Commission. Information contained on our Web site is not part of this report.

Item 1. Business

Company Overview

Avista Corporation (Avista Corp. or the Company), incorporated in the state of Washington in 1889, is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. As of December 31, 2008, we employed 1,482 people in our utility operations and 645 people in our subsidiary businesses. Our corporate headquarters are in Spokane, Washington, the hub of the Inland Northwest. Agriculture, mining and lumber were the primary industries in the Inland Northwest for many years; today health care, education, finance, electronic and other manufacturing, tourism and the service sectors are growing in importance.

We have two reportable business segments as follows:

Avista Utilities an operating division of Avista Corp. comprising our regulated utility operations that started in 1889. Our utility generates, transmits and distributes electricity and distributes natural gas. The utility also engages in wholesale purchases and sales of electricity and natural gas.

Advantage IQ an indirect subsidiary of Avista Corp. that provides sustainable utility expense management solutions, partnering with multi-site companies across North America to assess and manage utility costs and usage. Primary product lines include processing, payment and auditing of energy, telecom, waste, water/sewer and lease bills as well as strategic management services.

In prior periods, we had a reportable Energy Marketing and Resource Management segment. The activities of this business segment were conducted primarily by Avista Energy, Inc. (Avista Energy), an indirect subsidiary of Avista Corp. On June 30, 2007, Avista Energy and Avista Energy Canada, Ltd. completed the sale of substantially all of their contracts and ongoing operations to Shell Energy North America (U.S.), L.P. (Shell Energy), formerly known as Coral Energy Holding, L.P., as well as to certain other subsidiaries of Shell Energy. Completion of this transaction effectively ended the majority of the operations of this segment. This business still owns natural gas storage facilities and has operating revenues and resource costs related to the power purchase agreement for a 270 MW natural gas-fired combined cycle combustion turbine plant located in Idaho (Lancaster Plant). The Lancaster Plant is owned by an unrelated third-party and all of the output from the plant is contracted to Avista Energy through 2026. The majority of the rights and obligations of the power purchase agreement were assigned to Shell Energy through the end of 2009. Beginning in 2010, we expect these rights and obligations will be transferred to Avista Utilities, subject to future regulatory approval. These remaining activities do not represent a reportable business segment in 2008 and are included in the Other category for segment reporting purposes. The historical activities were reclassified to the Other category in accordance with the provisions of

Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information.

We have other businesses including sheet metal fabrication, venture fund investments and real estate investments. These activities do not represent a reportable business segment and are conducted by various indirect subsidiaries of Avista Corp., including Advanced Manufacturing and Development (AM&D), doing business as METALfx. Over time as opportunities arise, we plan to dispose of assets and phase out operations that do not fit with our overall corporate strategy. However, we may invest incremental funds to protect our existing investments and invest in new businesses that fit with our overall corporate strategy.

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Advantage IQ, Avista Energy, and the various other companies are subsidiaries of Avista Capital, Inc. (Avista Capital), which is wholly owned by Avista Corp. Our total common stockholders equity was $996.9 million as of December 31, 2008, of which $77.5 million represented our investment in Avista Capital.

Our organization is illustrated below:

AVA Formation Corp. (AVA) is the company formed for purposes of completing the potential statutory share exchange and holding company implementation. AVA is currently a subsidiary of Avista Corporation. For further information, see Note 28 of the Notes to Consolidated Financial Statements.

See Item 6. Selected Financial Data and Note 30 of the Notes to Consolidated Financial Statements for information with respect to the operating performance of each business segment (and other subsidiaries).

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Avista Utilities

General

Through our regulated utility operations, we generate, transmit and distribute electricity and distribute natural gas. Retail electric and natural gas customers include residential, commercial and industrial classifications. We also engage in wholesale purchases and sales of electricity and natural gas as an integral part of energy resource management and our load-serving obligation.

Our utility provides electric distribution and transmission, as well as natural gas distribution services in parts of eastern Washington and northern Idaho. We also provide natural gas distribution service in parts of northeast and southwest Oregon. At the end of 2008, we supplied retail electric service to 355,000 customers and retail natural gas service to 314,000 customers across our entire service territory. See Item 2. Properties for further information with respect to our utility assets.

Electric Operations

In addition to providing electric distribution and transmission services, we generate electricity from facilities that we own and we purchase capacity and energy and fuel for generation under long-term and short-term contracts. We also sell capacity and energy, including surplus fuel in the wholesale market in connection with our resource optimization activities as described below.

We engage in an ongoing process of resource optimization. This involves the economic selection from available energy resources to serve load obligations and using these resources to capture available economic value. We sell and purchase wholesale electric capacity and energy and fuel as part of the process of acquiring resources to serve our load obligations. These transactions range from terms of one hour up to multiple years. We make continuing projections of:

- electric loads at various points in time (ranging from one hour to multiple years) based on, among other things, estimates of factors such as customer usage and weather as well as historical data and contract terms, and
- resource availability at these points in time based on, among other things, 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 energy to match expected resources to expected electric load requirements. Resource optimization involves our generating plant dispatch and scheduling available resources, and also includes transactions such as:

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

The optimization process includes entering into hedging transactions to manage risks.

Our generation assets are interconnected through the regional transmission system and are operated on a coordinated basis to enhance load-serving capability and reliability. We provide transmission and ancillary services in eastern Washington, northern Idaho and western Montana. Our Open Access Same-Time Information System (OASIS) is part of the Joint Transmission Services Information Network that covers much of the United States. Transmission revenues were $9.5 million in 2008, $10.6 million in 2007 and $10.5 million in 2006.

Electric Requirements

Our peak electric native load requirement for 2008 occurred on December 16, 2008 at which time our total load was 2,383 MW consisting of:

- native load of 1,821 MW,
- long-term wholesale obligations of 270 MW, and
- short-term wholesale obligations of 292 MW.

At that time our maximum resource capacity available was 2,480 MW, which included:

- company-owned electric generation of 1,489 MW,
- long-term hydroelectric contracts with certain Public Utility Districts (PUDs) of 132 MW,
- other long-term wholesale contracts of 252 MW, and
- short-term wholesale purchases of 607 MW.

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Electric Resources

We have a diverse electric resource mix of hydroelectric projects, thermal generating facilities, and power purchases and exchanges.

At the end of 2008, our facilities had a total net capability of 1,768 MW, of which 56 percent was hydroelectric and 44 percent was thermal. See Item 2. Properties for detailed information with respect to generating facilities.

Hydroelectric Resources We own and operate six hydroelectric projects on the Spokane River and two hydroelectric projects on the Clark Fork River. Hydroelectric generation is our lowest cost source per megawatt-hour (MWh) of electricity and the availability of hydroelectric generation has a significant effect on total power supply costs. Under normal streamflow and operating conditions, we estimate that we would be able to meet approximately one-half of our total average electric requirements (both retail and long-term wholesale) with the combination of our hydroelectric generation and long-term hydroelectric purchase contracts with certain PUDs in the state of Washington. Our estimate of normal annual hydroelectric generation (including resources purchased under long-term hydroelectric contracts with certain PUDs) is 538 average megawatts (aMW) (or 4.7 million MWhs). Hydroelectric resources provided 535 aMW for 2008, 519 aMW for 2007 and 561 aMW for 2006.

The following table shows our hydroelectric generation (in thousands of MWhs) during the year ended December 31:

	2008	2007	2006
Noxon Rapids	1,696	1,591	1,824
Cabinet Gorge	1,081	1,088	1,146
Post Falls	85	83	97
Upper Falls	78	63	69
Monroe Street	104	100	106
Nine Mile	105	100	110
Long Lake	497	471	553
Little Falls	205	193	223
Total company-owned hydroelectric generation	3,851	3,689	4,128
Long-term hydroelectric contracts with PUDs	833	861	787
Total hydroelectric generation	4,684	4,550	4,915

Thermal Resources We own:

- the combined cycle combustion turbine (CT) natural gas-fired Coyote Springs 2 Generation Project (Coyote Springs 2) located near Boardman, Oregon,
- a 15 percent interest in a twin-unit, coal-fired boiler generating facility, the Colstrip 3 & 4 Generating Project (Colstrip) in southeastern Montana,
- a wood waste-fired boiler generating facility known as the Kettle Falls Generating Station (Kettle Falls GS) in northeastern Washington,

- a two-unit natural gas-fired CT generating facility, located in northeast Spokane (Northeast CT),
- a two-unit natural gas-fired CT generating facility in northern Idaho (Rathdrum CT), and
- two small natural gas-fired generating facilities (Boulder Park and Kettle Falls CT).

Coyote Springs 2, which is operated by Portland General Electric Corporation, is supplied with natural gas under both term contracts and spot market purchases, including transportation agreements with unilateral renewal rights.

Colstrip, which is operated by PPL Montana, LLC, is supplied with fuel from adjacent coal reserves under coal supply and transportation agreements in effect through 2019.

The primary fuel for the Kettle Falls GS is wood waste generated as a by-product and delivered by trucks from forest industry operations within 100 miles of the plant. Natural gas may be used as an alternate fuel. A combination of long-term contracts and spot purchases has provided, and is expected to meet fuel requirements for the Kettle Falls GS.

The Northeast CT, Rathdrum CT, Boulder Park and Kettle Falls CT generating units are primarily used to meet peaking electric requirements. We also operate these facilities when marginal costs are below prevailing wholesale electric prices. We did not operate these generating units significantly in 2008, 2007 and 2006. These generating facilities have access to natural gas supplies that are adequate to meet their respective operating needs.

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The following table shows our thermal generation (in thousands of MWhs) during the year ended December 31:

	2008	2007	2006
Coyote Springs 2	1,696	1,623	1,459
Colstrip	1,758	1,673	1,579
Kettle Falls GS	201	299	354
Northeast CT and Rathdrum CT	15	20	24
Boulder Park and Kettle Falls CT	23	25	18
Total thermal generation	3,693	3,640	3,434

Purchases, Exchanges and Sales We purchase and sell power under various long-term contracts. We also enter into short-term purchases and sales. See Electric Operations for additional information with respect to the use of wholesale purchases and sales as part of our resource optimization process.

Pursuant to the Public Utility Regulatory Policies Act of 1978 (PURPA), we are required to purchase generation from qualifying facilities, including small hydroelectric and cogeneration projects, at rates approved by the Washington Utilities and Transportation Commission (WUTC) and the Idaho Public Utilities Commission (IPUC). These contracts expire at various times between 2015 and 2027. In February 2006, the PURPA was amended by the Federal Energy Regulatory Commission (FERC) as required by the Energy Policy Act of 2005 (Energy Policy Act). These amendments are not expected to have an effect on our PURPA-related contracts.

See Avista Utilities Operating Statistics Electric Operations Electric Energy Resources for annual quantities of purchased power, wholesale power sales and power from exchanges in 2008, 2007 and 2006.

Hydroelectric Relicensing

We are a licensee under the Federal Power Act as administered by the FERC, which includes regulation of hydroelectric generation resources. Except for the Little Falls Plant, all of our hydroelectric plants are regulated by the FERC through project licenses. The licensed projects are subject to the provisions of Part I of the Federal Power Act. These provisions include payment for headwater benefits, condemnation of licensed projects upon payment of just compensation, and take-over of such projects after the expiration of the license upon payment of the lesser of net investment or fair value of the project, in either case, plus severance damages.

In March 2001, we received a 45-year operating license from the FERC for the Cabinet Gorge Hydroelectric Generating Project (Cabinet Gorge) and the Noxon Rapids Hydroelectric Generating Project (Noxon Rapids). The Clark Fork Settlement Agreement that was entered into during 1999 and incorporated into the FERC license preserved the projects economic peaking and load following operations. Also, as part of the Clark Fork Settlement Agreement, we initiated the implementation of protection, mitigation and enhancement measures in March 1999. Measures in the agreement address issues related to fisheries, water quality, wildlife, recreation, land use, cultural resources and erosion.

See Clark Fork Settlement Agreement in Note 26 of the Notes to Consolidated Financial Statements for disclosure of dissolved atmospheric gas levels that exceed state of Idaho and federal water quality standards downstream of Cabinet Gorge during periods when we must divert excess river flows over the spillway and our mitigation plans and efforts.

We own and operate six hydroelectric plants on the Spokane River, and five of these (Long Lake, Nine Mile, Upper Falls, Monroe Street and Post Falls, which have a total present capability of 144.1 MW) are under one FERC license and are referred to as the Spokane River Project. The sixth, Little Falls, is operated under separate Congressional authority and is not licensed by the FERC. Since the FERC was unable to issue new license orders prior to the August 1, 2007 (and subsequent August 1, 2008) expiration of the current license, an annual license was issued for all five plants, in effect extending the current license and its conditions until August 1, 2009. We have no reason to believe that Spokane River

Project operations will be interrupted in any manner relative to the timing of the FERC s actions.

We filed a Notice of Intent to Relicense in July 2002. The formal consultation process involving planning and information gathering with stakeholder groups lasted through July 2005, when we filed our new license applications with the FERC. We initially requested the FERC to consider a license for Post Falls, which has a present capability of 18 MW, separately from the other four hydroelectric plants due to the complexity of issues related to the Post Falls development. In the license applications, we proposed a number of measures intended to address the impact of the Spokane River Project and enhance resources associated with the Spokane River. FERC licenses are granted for terms of 30 to 50 years.

Since our July 2005 filing of applications to relicense the Spokane River Project, the FERC has continued various stages of processing the applications. In May 2006, the FERC issued a notice requesting other parties to provide terms and conditions regarding the two license applications. In response to that notice, a number of parties including the Coeur d Alene Tribe (the Tribe), the state of Idaho, Washington state agencies, and the United States Department of Interior (DOI)) filed either recommended terms and conditions, pursuant to Sections 10(a) and 10(j) of the Federal Power Act

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(FPA), or mandatory conditions related to the Post Falls application, pursuant to Section 4(e) of the FPA. In January 2007, the FERC issued a draft Environmental Impact Statement (EIS). After review of comments, the FERC issued a final EIS in July 2007. This was the last administrative step for the FERC before the issuance of license orders; however, the FERC was unable to move forward prior to Federal Clean Water Act 401 Water Quality Certifications (Certifications) being issued by the states of Idaho and Washington.

The states of Idaho and Washington issued Certifications for the Project on June 5, 2008 and June 10, 2008, respectively. The Idaho Certification was based on a Settlement Agreement between Avista Corp., Idaho Department of Environmental Quality and the Idaho Department of Fish and Game, and is final. The Washington Certification, which was issued by the Washington Department of Ecology (Ecology), however, was appealed by Avista Corp., Inland Empire Paper and the Sierra Club/Center for Environmental Law and Policy. All issues, with the exception of one appealed by the Sierra Club/Center for Environmental Law and Policy (aesthetic spills at the Upper Falls plant) were resolved through a four-party Settlement Agreement. We are continuing negotiations on the remaining issue. A hearing is scheduled before the Washington Pollution Control Hearing Board in August 2009 to address the remaining issue under appeal.

On December 16, 2008 Avista, the United States DOI, and the Tribe reached agreement resolving FPA Section 4(e) conditions, as well as the payment of annual charges under Section 10(e) of the FPA regarding Post Falls, which stores water on a portion of the Coeur d Alene Indian Reservation. The three parties submitted a request to the FERC on January 29, 2009 to incorporate the agreed-upon terms and conditions in a new single 50-year license for all five Spokane River hydroelectric plants.

The United States Department of Fish and Wildlife concurred, via a letter to FERC on July 31, 2008, that the Spokane River Project is not likely to adversely affect any listed or threatened endangered species.

We can not determine exactly when the FERC will complete action on the applications. Once granted, a new license will describe the final conditions we will be responsible to implement, and the term for a new license.

Our estimate of the potential cost of the conditions proposed for the Spokane River Project, based on estimates of what it would cost to implement the recommendations and conditions included in the FERC s final EIS and the numerous Settlement Agreements, total approximately $305 million over a 50-year period.

In addition, the December 16, 2008 settlement agreement between the Company and the Tribe resolved FPA Section 10(e), or storage payments related to the Post Falls hydroelectric facility. Under the agreement, we will pay the Coeur d Alene Tribe $0.4 million annually for the first 20 years of a new FERC license and $0.7 million annually for the remainder of the license term for section 10(e) charges.

The WUTC approved, for future recovery, costs incurred in relicensing the Spokane River project, as well as the costs related to settlement with the Tribe. The WUTC approved deferred accounting treatment, with a carrying cost, until these costs are reflected in future retail rates. The IPUC approved similar deferred accounting treatment. Our general rate cases, filed in January 2009, reflect recovery of both the direct and deferred costs.

Future Resource Needs

We have operational strategies to provide sufficient resources to meet our energy requirements under a range of operating conditions. These operational strategies consider the amount of energy needed over hourly, daily, monthly and annual durations, which vary widely because of the factors that influence demand. The following is a forecast of our average annual energy requirements and resources for 2009, 2010, 2011 and 2012:

Forecasted Electric Energy Requirements and Resources

(aMW)

	2009	2010	2011	2012
Requirements:				
System load	1,119	1,148	1,171	1,189
Contracts for power sales	140	139	139	139
Total requirements	1,259	1,287	1,310	1,328

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	2009	2010	2011	2012
Resources:				
Company-owned and contract hydro generation (1)	555	537	520	508
Company-owned base load thermal generation (2)	234	237	247	235
Company-owned other thermal generation (2)	294	291	281	292
Contracts for power purchases	367	604	521	487
Total resources	1,450	1,669	1,569	1,522
Surplus resources	191	382	259	194
Additional available energy (3)	153	153	153	153
Total surplus resources	344	535	412	347

(1) The forecast assumes near normal hydroelectric generation (decline is related to changes in contracts with PUDs).

(2) Excludes the Northeast CT and Rathdrum CT. We generally use these resources to meet electric load requirements due to either below normal hydroelectric generation or increased loads or outages at other generating facilities, and/or when operating costs are lower than short-term wholesale market prices.

(3) Northeast CT and Rathdrum CT. The combined maximum capacity of the Northeast CT and Rathdrum CT is 243 MW, with estimated available energy production as indicated for each year.

In August 2007, we filed our 2007 Electric Integrated Resource Plan (IRP) with the WUTC and the IPUC. The IRP identifies a strategic resource portfolio that meets future electric load requirements, promotes environmental stewardship and meets our obligation to provide reliable electric service to customers at rates, terms and conditions that are fair, just, reasonable and sufficient. We regard the IRP as a tool for resource evaluation, rather than an acquisition plan for a particular project. Our preferred resource plan, which is part of the IRP, includes the addition of the following resources by 2017:

- 350 MW of natural gas generation,
- 300 MW of wind power,
- 87 MW of conservation,
- 38 MW of hydroelectric generation plant upgrades, and
- 35 MW of other renewable generation.

In response to new laws in the state of Washington regarding renewable resources and greenhouse gas emissions, the IRP excludes coal-based generation as a new resource. The amount of renewable resources in our future IRPs could change if the cost effectiveness of those resources changes.

We are required to file an IRP every two years. We will file an IRP in 2009 and the Preferred Resource Strategy may change based upon market, legislative and regulatory changes.

All of the output from the Lancaster Plant is contracted to Avista Energy through 2026 under a power purchase agreement. Avista Energy assigned the majority of its rights and obligations under this agreement to Shell Energy through the end of 2009. Beginning in 2010, we expect that these rights and obligations will be transferred to our utility operations, subject to approval by the WUTC and the IPUC.

In the second quarter of 2008, we completed the acquisition of a wind generation site. We expect to construct a 50 MW generation facility at an estimated cost of over $125 million with the majority of the costs expected to be incurred in 2013 and thereafter.

See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Environmental Issues and Other Contingencies for information with respect to existing laws, as well as potential legislation that could influence our future electric resource mix.

Natural Gas Operations

General We provide natural gas distribution services to retail customers in parts of eastern Washington, northern Idaho, and parts of northeast and southwest Oregon.

Market prices for natural gas, like other commodities, continue to be volatile. To provide reliable supply and to manage the impact of volatile prices on our customers, we procure natural gas through a diversified mix of spot market purchases and forward fixed price purchases from various supply basins and over various time periods. We also use natural gas storage capacity to support high demand periods and to procure natural gas when prices are likely to be seasonally lower. Securing prices throughout the year and even into subsequent years at multiple basins mitigates potential adverse impacts of significant purchase requirements in a volatile price environment.

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As part of the process of balancing natural gas retail load requirements to resources obtained through wholesale purchases, we engage in wholesale sales of natural gas. We also optimize natural gas resources by using excess resources and market opportunities to generate economic value that reduces retail rates. To the extent that our retail demand for natural gas is less than our available supply, or that we have under utilized interstate pipeline transportation capacity or excess storage capacity and there are price differentials that provide positive margins, we engage in wholesale sales of natural gas. These optimization activities increased significantly in 2008 as compared 2007. Wholesale sales are delivered through wholesale market facilities outside of our natural gas distribution system.

We make continuing projections of our natural gas loads and assess available natural gas resources. Forward natural gas contracts are typically for monthly delivery periods. However, daily variations in natural gas demand can be significantly different than monthly demand projections. On the basis of these projections, we plan and execute a series of transactions to hedge a significant portion of our projected natural gas requirements through forward market transactions and derivative instruments. These transactions may extend as much as four years into the future with the highest volumes hedged for the current and most immediately upcoming gas operating year (November through October). We also purchase a significant portion of our gas supply requirements in short-term and spot markets. Natural gas resource optimization activities include:

- wholesale market sales of surplus gas supplies,
- purchases and sales of natural gas to use underutilized pipeline capacity, and
- sales of excess natural gas storage capacity.

We also provide transportation service to certain large commercial and industrial natural gas customers who purchase natural gas through third party marketers. For these customers, we move their natural gas through our distribution system from the natural gas transmission pipeline delivery points to the customers premises. The total volume transported on behalf of our transportation customers for 2008, 2007 and 2006 was 148.7, 148.8 and 149.7 million therms. This represented 18 percent, 21 percent and 24 percent of total system deliveries.

Natural Gas Supply We purchase all of our natural gas in the wholesale market. We are connected to multiple supply basins in the western United States and western Canada through firm capacity delivery rights on five pipeline networks. Access to this diverse portfolio of natural gas resources allows us to make natural gas procurement decisions that benefit our natural gas customers. We have interstate pipeline capacity to serve approximately 25 percent of natural gas supplies from domestic sources, with the remaining 75 percent from Canadian sources. Natural gas prices in the Pacific Northwest are affected by global energy markets, as well as supply and demand factors in other regions of the United States and Canada. Future prices and delivery constraints may cause our source mix to vary.

Natural Gas Storage We own a one-third interest in the Jackson Prairie Natural Gas Storage Project (Jackson Prairie), an underground natural gas storage field located near Chehalis, Washington. Jackson Prairie has a total peak day deliverability of 11.5 million therms, with a total working natural gas capacity of 239.5 million therms.

We also contract with Northwest Natural Gas for storage at the Mist Natural Gas storage facility. This contract is for 5 million therms of capacity and up to 150 million therms of deliverability. This contract expires on March 31, 2010.

Natural gas storage enables us to place natural gas into storage when prices are lower or to satisfy minimum natural gas purchasing requirements, as well as to meet high demand periods or to withdraw natural gas from storage when spot prices are higher.

Avista Energy controls 30.3 million therms of our capacity at Jackson Prairie and in conjunction with the asset sales agreement has assigned this capacity to Shell Energy through April 30, 2011. After that date, it is our intent to transfer this capacity to Avista Utilities for use in utility operations subject to regulatory approval.

Regulatory Issues

General As a regulated public utility, we are subject to regulation by state utility commissions with respect to prices, accounting, the issuance of securities, and other matters. The retail electric and natural gas operations are subject to the jurisdiction of the WUTC, the IPUC, the Public Utility Commission of Oregon (OPUC), and the Public Service Commission of the State of Montana (Montana Commission). Approval of the issuance of securities is not required from the Montana Commission. We are also subject to the jurisdiction of the FERC for licensing of hydroelectric generation resources, and for electric transmission service and wholesale sales.

Our rates for retail electric and natural gas services (other than specially negotiated retail rates for industrial or large commercial customers, which are subject to regulatory review and approval) are determined on a cost of service basis. Rates are designed to provide, after recovery of allowable operating expenses, an opportunity for us to earn a reasonable return on rate base. Rate base is generally determined by reference to the original cost (net of accumulated depreciation) of utility plant in service, subject to various adjustments for deferred taxes and other items. Over time, rate

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base is increased by additions to utility plant in service and reduced by depreciation and retirement of utility plant and write-offs as authorized by the utility commissions. In general, a request of new rates is made on the basis of a rate base as of a date prior to the date of the request and allowable operating expenses for a 12-month test period ended prior to the date of the request. Although the current rate making process provides recovery of some future changes in rate base and operating costs, it does not reflect all changes in costs for the period in which new retail rates will be in place. This results in a lag between the time we incur costs and the time when we can start recovering the costs through rates.

Our rates for wholesale electric and natural gas transmission services are based on either cost of service principles or market-based rates as set forth by the FERC. See Note 1 of Notes to Consolidated Financial Statements for additional information about regulation, depreciation and deferred income taxes. See Industry Developments for additional information about deregulation, as well as changes with respect to transmission and wholesale electricity markets.

General Rate Cases We regularly review the need for electric and natural gas rate changes in each state in which we provide service. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Avista Utilities Regulatory Matters General Rate Cases for information on general rate case activity.

Power Cost Deferrals We defer the recognition in the income statement of certain power supply costs that vary from the level currently recovered from our retail customers as authorized by the WUTC and the IPUC. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Avista Utilities Regulatory Matters Power Cost Deferrals and Recovery Mechanisms and Note 1 Power Cost Deferrals and Recovery Mechanisms of the Notes to Consolidated Financial Statements for detailed information on power cost deferrals and recovery mechanisms in Washington and Idaho.

Purchased Gas Adjustment (PGA or Natural Gas Trackers) Under established regulatory practices in each respective state, we are allowed to adjust natural gas rates periodically (with regulatory approval) to reflect increases or decreases in the cost of natural gas purchased. Differences between actual natural gas costs and the natural gas costs included in retail rates are deferred and charged or credited to expense when regulators approve inclusion of the cost changes in rates. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Avista Utilities Regulatory Matters Purchased Gas Adjustments and Note 1 Natural Gas Cost Deferrals and Recovery Mechanisms of the Notes to Consolidated Financial Statements for detailed information on natural gas cost deferrals and recovery mechanisms in Washington, Idaho and Oregon.

Industry Developments

Energy Policy Act of 2005 In August 2005, the Energy Policy Act was passed into law. The Energy Policy Act substantially affects the regulation of energy companies, including Avista Corp. Key provisions of the Energy Policy Act affecting us include, but are not limited to:

- reform of the hydroelectric licensing process,
- tax credits for incremental hydroelectric production placed into service before 2009,
- implementation of mandatory reliability standards, and
- authorization for the FERC to assess fines for non-compliance with FERC regulations and mandatory reliability standards.

The Energy Policy Act also has provisions related to the future operation and development of transmission systems and federal support for certain clean power initiatives and renewable energy technologies, including wind power generation. The Energy Policy Act repealed the Public Utility Holding Company Act of 1935 and, among other things:

- granted the FERC and state utility commissions access to the books and records of holding company systems,
- provides (upon request of a state commission or holding company system) for FERC review of allocations of costs of non-power goods and administrative services, and
- modifies the jurisdiction of the FERC over certain mergers and acquisitions involving public utilities or holding companies.

The implementation of the Energy Policy Act requires proceedings at the state level and the development of regulations by the FERC, the Department of Energy and other federal agencies.

Federal Initiatives Related to Wholesale Competition Federal law promotes practices that open the electric wholesale energy market to competition. The FERC can require electric utilities to transmit power and energy to or for wholesale purchasers and sellers, and to require electric utilities to enhance or construct transmission facilities to create additional transmission capacity for the purpose of providing these services. Public utilities (through subsidiaries) and other entities may participate in the development of independent electric generating plants for sales to wholesale customers.

Public utilities operating under the Federal Power Act are required to provide open and non-discriminatory access to their transmission systems to third parties and establish an OASIS to provide an electronic means by which transmission customers can obtain information about available transmission capacity and purchase transmission access. The FERC

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also requires each public utility subject to the rules to operate its transmission and wholesale power merchant operating functions separately and comply with standards of conduct designed to ensure that all wholesale users, including the public utility s power merchant operations, have equal access to the public utility s transmission system. Our compliance with these standards has not had any substantive impact on the operation, maintenance and marketing of our transmission system or our ability to provide service to customers.

Regional Transmission Organizations FERC Order No. 2000 (issued in 2000) required all utilities subject to FERC regulation to file a proposal to form a Regional Transmission Organization (RTO), or a description of efforts to participate in an RTO, and any existing obstacles to RTO participation. While it has not formally withdrawn Order No. 2000, the FERC has issued orders and made public policy statements indicating its support for the development and formation of regional independently-governed transmission organizations developed by such regions, but that do not necessarily meet all of the RTO functions and characteristics outlined in Order No. 2000. These include FERC Order No. 890 (issued in 2007), which required transmission providers to implement a number of regional transmission planning coordination requirements.

We have participated in discussions with transmission providers and other stakeholders in the Pacific Northwest for several years regarding the possible formation of an RTO in the region. ColumbiaGrid, a Washington nonprofit membership corporation, was formed to improve the operational efficiency, reliability, and planned expansion of the transmission grid in the Pacific Northwest. ColumbiaGrid members, including Avista Corp., elected an independent slate of directors to a three-member board in August 2006. ColumbiaGrid s responsibilities and related agreements with its members are currently being developed in a public process with broad participation. ColumbiaGrid s transmission planning and expansion functional agreement was accepted by the FERC and has been signed by a number of Pacific Northwest parties, including Avista Corp. We will continue to assess the benefits of entering into other functional agreements with ColumbiaGrid.

Reliability Standards As a result of a significant blackout in northeastern and midwestern United States in 2003, the North American Electric Reliability Council (NERC), in conjunction with the FERC, conducted a comprehensive investigation of the outage and issued certain reliability-related recommendations. These recommendations addressed compliance with existing national and regional standards and initiatives to prevent or mitigate future blackouts. In February 2005, the NERC Board of Trustees approved voluntary reliability standards with the goal of restating existing standards in a manner that is clear, unambiguous, measurable and enforceable.

In February 2006, the FERC issued its final rule on the certification rules for a single Electric Reliability Organization (ERO). The NERC has been approved as the ERO and now has the authority to establish and enforce reliability standards, and has the ability to delegate authority to regional entities for the purpose of establishing and enforcing reliability standards.

As of January 2009, the FERC has approved 102 NERC Reliability Standards, including eight western region standards, making up the set of legally enforceable standards for the United States bulk electric system. The first of these mandatory Reliability Standards became effective on June 18, 2007. We are required to self certify with regards to compliance with these mandatory standards. We are in compliance with these standards.

Global Climate Changes Rising concerns about long-term global climate changes could have a significant effect on our business. We continue to monitor and evaluate the possible adoption of national, regional, or state requirements with respect to global climate changes. These requirements could result in significant costs for us to comply with restrictions on carbon dioxide and other emissions. Such requirements could also preclude us from developing certain types of generating plants or entering into new contracts for the output from generating plants that do not meet these requirements. See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Environmental Issues and Other Contingencies for further information.

Environmental Issues

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

In addition to the information provided in this section, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Environmental Issues and Other Contingencies for further information.

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. Thus far, measures that were adopted and implemented to save the Snake River sockeye salmon and fall chinook salmon

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have not directly impacted generation levels at any of our hydroelectric facilities. We purchase power under long-term contracts with certain PUDs 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 accurately predict the economic costs to us resulting from future actions. 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, particularly bull trout, is a key part of the agreement. The result is a collaborative bull trout recovery 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. See Hydroelectric Relicensing on page 5 for further information.

Air Quality We must be in compliance with requirements under the Clean Air Act (CAA) and Clean Air Act Amendments (CAAA) in operating our thermal generating plants. We continue to monitor legislative developments at both the state and national level for potential further restrictions on sulfur dioxide, nitrogen oxide and carbon dioxide, as well as other greenhouse gas and mercury emissions. Compliance with new and proposed requirements and possible additional legislation or regulations will result in increases to capital expenditures and operating expenses for expanded emission controls at the Company s thermal generating facilities.

The most significant impacts on us, related to the CAA and the 1990 CAAA, pertain to Colstrip, which is a Phase II coal-fired plant for sulfur dioxide (SO2) under the CAAA. However, we do not expect Colstrip to be required to implement any additional SO2 mitigation in the foreseeable future in order to continue operations. Our other thermal projects are subject to various CAAA standards. Every five years each of the other thermal projects requires an updated operating permit (known as a Title V permit), which addresses, among other things, the compliance of the plant with the CAAA. The operating permit for the Rathdrum CT was renewed in 2006 (expires in 2011) and the operating permit for the Kettle Falls GS was renewed in 2007 (expires in 2012). Coyote Springs 2 was issued a renewed Title V permit in 2008 that expires in 2013. Boulder Park and the Northeast CT do not require a Title V permit based on their limited output and instead each has a synthetic minor permit that does not expire.

In 2006, the Montana Department of Environmental Quality (Montana DEQ) adopted final rules for the control of mercury emissions from coal-fired plants. The new rules set strict mercury emission limits by 2010, and put in place a recurring ten-year review process to ensure facilities are keeping pace with advancing technology in mercury emission control. The rules also provide for temporary alternate emission limits provided certain provisions are met, and they allocate mercury emission credits in a manner that rewards the cleanest facilities. The Company, along with the other owners of Colstrip, have completed the first phase of testing on two mercury control technologies. The joint owners of Colstrip were encouraged by preliminary results and believe that we will be able to comply with the Montana law without utilizing the temporary alternate emission limit provision. Preliminary estimates indicate that our share of installation capital costs will be $1.5 million and annual operating costs will increase by $2.9 million (beginning in late-2009). We will continue to seek recovery, through the ratemaking process, of the costs to comply with various air quality requirements.

Water Quality See Clark Fork Settlement Agreement in Note 26 of the Notes to Consolidated Financial Statements regarding dissolved atmospheric gas levels that exceed state of Idaho and federal water quality standards downstream of Cabinet Gorge. See Spokane River Relicensing in Note 26 of the Notes to Consolidated Financial Statements for the Clean Water Act certifications for our relicensing of the Spokane River Project.

Other Environmental Issues See Colstrip Generating Project Complaint, and Harbor Oil Inc. Site in Note 26 of the Notes to Consolidated Financial Statements for information with respect to additional environmental issues.

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AVISTA UTILITIES OPERATING STATISTICS

	Years Ended December 31,		
	2008	**2007**	**2006**
ELECTRIC OPERATIONS			
ELECTRIC OPERATING REVENUES (Dollars in Thousands):			
Residential	$ 279,641	$ 251,357	$ 234,714
Commercial	247,714	224,179	221,193
Industrial	101,785	95,207	92,961
Public street and highway lighting	5,962	5,517	5,268
Total retail revenues	635,102	576,260	554,136
Wholesale revenues	141,744	105,729	126,208
Revenues from sales of fuel	44,695	12,910	48,176
Other revenues	16,916	16,231	18,863
Total electric operating revenues	$ 838,457	$ 711,130	$ 747,383
ELECTRIC ENERGY SALES (Thousands of MWhs):			
Residential	3,744	3,670	3,578
Commercial	3,188	3,132	3,110
Industrial	2,059	2,084	2,062
Public street and highway lighting	26	26	25
Total retail energy sales	9,017	8,912	8,775
Wholesale energy sales	1,964	1,594	2,117
Total electric energy sales	10,981	10,506	10,892
ELECTRIC ENERGY RESOURCES (Thousands of MWhs):			
Hydro generation (from Company facilities)	3,851	3,689	4,128
Thermal generation (from Company facilities)	3,693	3,640	3,434
Purchased power - hydro generation from long-term contracts with PUDs	833	861	787
Purchased power - wholesale	3,253	2,959	3,101
Power exchanges	(17)	(18)	35
Total power resources	11,613	11,131	11,485
Energy losses and Company use	(632)	(625)	(593)
Total energy resources (net of losses)	10,981	10,506	10,892
NUMBER OF ELECTRIC RETAIL CUSTOMERS (Average for Period):			
Residential	311,381	306,737	300,940
Commercial	39,075	38,488	37,912
Industrial	1,388	1,378	1,388
Public street and highway lighting	434	426	425

Total electric retail customers	352,278	347,029	340,665
ELECTRIC RESIDENTIAL SERVICE AVERAGES:			
Annual use per customer (KWh)	12,023	11,965	11,888
Revenue per KWh (in cents)	7.47	6.85	6.56
Annual revenue per customer	$ 898.07	$ 819.45	$ 779.94
ELECTRIC AVERAGE HOURLY LOAD (aMW)	1,102	1,089	1,069
RESOURCE AVAILABILITY at time of system peak (MW):			
Total requirements (winter):			
Retail native load	1,821	1,685	1,656
Wholesale obligations	562	367	431
Total requirements (winter)	2,383	2,052	2,087
Total resource availability (winter)	2,480	2,302	2,618
Total requirements (summer):			
Retail native load	1,602	1,631	1,643
Wholesale obligations	431	381	588
Total requirements (summer)	2,033	2,012	2,231
Total resource availability (summer)	2,250	2,434	2,551
COOLING DEGREE DAYS: (1)			
Spokane, WA			
Actual	478	576	615
30-year average	394	394	394
% of average	121%	146%	156%

(1) Cooling degree days are the measure of the warmness of weather experienced, based on the extent to which the average of high and low temperatures for a day exceeds 65 degrees Fahrenheit (annual degree days above historic indicate warmer than average temperatures).

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AVISTA UTILITIES OPERATING STATISTICS

	Years Ended December 31,		
	2008	**2007**	**2006**
NATURAL GAS OPERATIONS			
NATURAL GAS OPERATING REVENUES (Dollars in Thousands):			
Residential	$ 276,386	$ 264,546	$ 257,753
Commercial	152,147	148,416	146,581
Industrial and interruptible	12,159	11,284	11,676
Total retail natural gas revenues	440,692	424,246	416,010
Wholesale revenues	281,668	142,167	93,221
Transportation revenues	6,327	6,638	6,499
Other revenues	5,520	4,182	4,825
Total natural gas operating revenues	$ 734,207	$ 577,233	$ 520,555
THERMS DELIVERED (Thousands of Therms):			
Residential	210,125	195,756	192,833
Commercial	128,224	121,557	120,989
Industrial and interruptible	12,196	10,833	11,040
Total retail	350,545	328,146	324,862
Wholesale	345,916	223,084	154,884
Transportation	148,723	148,765	149,717
Interdepartmental and Company use	526	438	443
Total therms delivered	845,710	700,433	629,906
SOURCES OF NATURAL GAS SUPPLY (Thousands of Therms):			
Purchases	710,137	561,277	483,038
Storage - injections	(76,491)	(35,228)	(17,892)
Storage - withdrawals	66,271	28,842	18,181
Natural gas for transportation	148,723	148,765	149,717
Distribution system losses	(2,930)	(3,223)	(3,138)
Total natural gas supply	845,710	700,433	629,906
NUMBER OF NATURAL GAS RETAIL CUSTOMERS (Average for Period):			
Residential	277,892	273,415	267,345
Commercial	32,901	32,327	31,746
Industrial and interruptible	297	302	295
Total natural gas retail customers	311,090	306,044	299,386

NATURAL GAS RESIDENTIAL SERVICE AVERAGES:

Annual use per customer (therms)	756	716	721
Revenue per therm (in dollars)	$ 1.32	$ 1.35	$ 1.34
Annual revenue per customer	$ 994.58	$ 967.56	$ 964.12
HEATING DEGREE DAYS: (1)			
Spokane, WA			
Actual	7,052	6,539	6,332
30-year average	6,820	6,820	6,820
% of average	103%	96%	93%
Medford, OR			
Actual	4,569	4,386	4,167
30-year average	4,533	4,533	4,533
% of average	101%	97%	92%

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

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Advantage IQ

Our subsidiary, Advantage IQ provides sustainable utility expense management solutions to multi-site companies across North America to assess and manage utility costs and usage. Our invoice processing, auditing and payment services, coupled with energy procurement, comprehensive reporting and advanced analysis, provide the critical data clients need to balance the financial, social and environmental aspects of doing business.

As part of this process, Advantage IQ analyzes and audits invoices, then presents consolidated bills on-line, as well as processing payments for these expenses. Information gathered from invoices, providers and other customer-specific data allows Advantage IQ to provide its clients with in-depth analytical support, real-time reporting and consulting services.

Advantage IQ has secured five patents on its two critical business systems:

- Facility IQ system, which provides operational information drawn from facility bills, and

- AviTrack database, which processes and reports on information gathered from service providers to ensure that customers are receiving the most effective services at the proper price.

We are not aware of any claimed or threatened infringement on any of Advantage IQ s patents issued to date and we expect to continue to expand and protect existing patents, as well as file additional patent applications for new products, services and process enhancements.

The following table presents key statistics for Advantage IQ:

	2008	2007	2006
Customers at year-end	537	403	373
Billed sites at year-end	417,078	199,088	199,752
Dollars of customer bills processed (in billions)	$ 16.7	$ 12.5	$ 10.8

The 2008 amounts include customers and sites of Cadence Network, which was acquired by Advantage IQ in July 2008 (see Note 5 of the Notes to Consolidated Financial Statements).

Other Businesses

In prior periods, we had a reportable Energy Marketing and Resource Management segment. This segment primarily included the results of Avista Energy. On June 30, 2007, Avista Energy and its subsidiary, Avista Energy Canada, completed the sale of substantially all of their contracts and ongoing operations to Shell Energy, as well as to certain other subsidiaries of Shell Energy. Completion of this transaction effectively ended the majority of the operations of this business segment. Avista Energy Canada provided natural gas services to industrial and commercial customers in British Columbia, Canada.

The historical activities of Avista Energy included trading electricity and natural gas, the optimization of generation assets owned by other entities, long-term electric supply contracts, natural gas storage and electric transmission and natural gas transportation arrangements.

This business still owns natural gas storage facilities and has operating revenues and resource costs related to the power purchase agreement for the Lancaster Plant. These remaining activities do not represent a reportable business segment in 2008 and are included in the Other category for segment reporting purposes. We expect these assets to eventually be transferred to our utility operations, subject to regulatory approval.

Our other businesses include AM&D doing business as METALfx, a subsidiary that performs custom sheet metal fabrication of electronic enclosures, parts and systems for the computer, telecom and medical industries. Our other investments and operations include:

- real estate investments (primarily commercial office buildings),
- investments in venture capital funds and low income housing, and
- the remaining investment in a previous fuel cell subsidiary of the Company.

Over time as opportunities arise, we plan to dispose of assets and phase out operations that do not fit with our overall corporate strategy. However, we may invest incremental funds to protect our existing investments and invest in new businesses that fit with our overall corporate strategy.

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Item 1A. Risk Factors

Risk Factors

The following factors could have a significant impact on our operations, results of operations, financial condition or cash flows. These factors could cause actual results or outcomes to differ materially from those discussed in our reports filed with the Securities and Exchange Commission (including this Annual Report on Form 10-K), and elsewhere. Please also see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements for additional factors which could have a significant impact on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in such statements.

Our results of operations, financial condition and cash flows are significantly affected by weather.

Weather has a significant effect on our utility operations related to variations in temperatures and precipitation. Weather impacts include customer demand and operating revenues and the cost of energy we supply. We normally have our highest retail (electric and natural gas) energy sales during the winter heating season in the first and fourth quarters of the year. We also have high electricity demand for air conditioning during the summer (third quarter). In general, warmer weather in the heating season and cooler weather in the cooling season will reduce our customers energy demand and retail operating revenues.

Precipitation (consisting of snowpack and its melting pattern plus rainfall) and other streamflow conditions (such as regional water storage operations) significantly impact hydroelectric generation capability. Variations in hydroelectric generation inversely affect our reliance on market purchases and thermal generation. There is a significantly higher cost for resources other than hydroelectric generation, and these costs can be greater than the retail revenue from the related energy delivered to customers.

Regional precipitation and snowpack conditions typically have a significant effect on the wholesale price of electricity. Plentiful hydroelectric generation typically depresses market prices, sometimes when we are selling surplus energy, while constrained hydroelectric generation typically elevates market prices, sometimes when we are purchasing energy. In general, high demand for electricity will generally increase both the quantity needed and price of fuel for generation and wholesale market prices. These price patterns typically fluctuate seasonally with regional supply and demand and they are exaggerated or moderated by the relative level of supply, fuel costs, and end user energy demand.

As a result of these factors operating in combination, our net cost of power supply the difference between our generating and market purchases costs and revenue from wholesale sales varies significantly because of weather.

Financial market conditions may impact our results and our liquidity

The deterioration in the financial markets and credit availability that arose in 2008 and the current state of the global, United States and regional economies could have an impact on our operations. We could experience increased borrowing costs or limited access to capital on reasonable terms. Additionally, we may experience an increase in uncollectible customer accounts and collection times. The consequences of a prolonged recession may include a lower level of economic activity and uncertainty regarding energy prices. A lower level of economic activity might result in a decline in energy consumption, which may adversely affect our revenues and future growth. Concerns about the regional or local economy may also influence the willingness of regulators to grant necessary rate increases to recover our costs.

The deterioration in the financial markets has also resulted in significant declines in the market values of assets held by our pension plan (which impacts the funded status of the plan) and will increase future funding obligations and pension expense.

We rely on access to credit from financial institutions for short-term borrowings.

We need to maintain access to adequate levels of credit with financial institutions for short-term liquidity. We have a $320 million committed line of credit, which is scheduled to expire in April 2011, and a $200 million committed line of credit, which is scheduled to expire in November

2009. We cannot predict whether we will have access to credit beyond the expiration dates. The line of credit agreements contain customary covenants and default provisions. In the event of 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.

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We are dependent on our ability to access long-term capital markets.

We need to access long-term capital markets to finance capital expenditures, repay maturing long-term debt and obtain additional working capital from time to time. Our ability to access capital on reasonable terms is subject to numerous factors and market conditions, many of which are beyond our control. If we are unable to obtain capital on reasonable terms, it may limit or prohibit 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 are subject to commodity price risk.

Our utility operations are affected by electric and natural gas commodity price risk. Changes in wholesale energy prices affect, among other things, the cash requirements to purchase electricity and natural gas for retail customers or wholesale obligations and the market value of derivative assets and liabilities.

Electricity prices are affected by a number of factors, including:

- demand for electricity,
- the number of market participants and the willingness of market participants to trade,
- adequacy of generating reserve margins,
- scheduled and unscheduled outages of generating facilities,
- availability of streamflows for hydroelectric generation,
- price and availability of fuel for thermal generating plants, and
- disruptions of or constraints on transmission facilities.

Natural gas prices are affected by a number of factors, including:

- amount of North American production and production capacity that can be delivered to our service areas,
- level of imports and exports, particularly from Canada by pipeline and to a growing extent by LNG,

- inventory levels and regional accessibility,
- demand for natural gas, including natural gas as fuel for electric generation,
- the number of market participants and the willingness of market participants to trade,
- global energy markets, including oil or other natural gas substitutes, and
- availability of pipeline capacity to transport natural gas from region to region.

Any combination of these factors that results in a shortage of energy generally causes the market price to move upward.

Regulators may not grant rates that provide timely or sufficient recovery of our costs or allow a reasonable rate of return for our shareholders.

We regularly review the need for retail electric and natural gas rate changes in each state in which we provide service. We expect to periodically file for rate increases with regulatory agencies to recover our costs and provide a reasonable return to our shareholders. If regulators grant substantially lower rate increases than our requests in the future, it could have a negative effect on our operating revenues, net income and cash flows.

Deferred power and natural gas costs are subject to regulatory review; costs higher than those recovered in base rates reduce cash flows, and it may take several years for us to recover deferred costs.

We defer income statement recognition and current recovery from customers of certain power and natural gas costs that are higher than what is currently authorized by regulators. These excess power and natural gas costs are recorded as deferred charges with the opportunity for future recovery through retail rates. These deferred costs are subject to review for prudence and for the potential of disallowance by state regulators.

Despite the opportunity to eventually recover a substantial portion of power and natural gas costs, our operating cash flows are negatively affected until these costs are recovered from customers.

Relicensing our hydroelectric facilities located on the Spokane River at a cost-effective level with reasonable terms and conditions may not be possible.

We have six hydroelectric plants on the Spokane River, and five of these are under one FERC license. Collectively,

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these five plants are referred to as the Spokane River Project. Since the FERC was unable to issue new license orders prior to the August 1, 2007 (and subsequent August 1, 2008) expiration of the current license, an annual license was issued for all five plants, in effect extending the current license and its conditions until August 1, 2009.

The relicensing process for the Spokane River Project is a public regulatory process that involves complex natural resource, recreation and cultural issues. We cannot predict the terms and conditions that will ultimately be imposed by the FERC. The costs of these terms and conditions could have a negative effect on our operating expenses and require significant utility capital expenditures reducing net income and cash flows. We also cannot predict whether the FERC will ultimately issue new licenses or whether we will be willing to meet the licensing requirements to continue to operate the Spokane River Project. We plan to request regulatory approval to recover future licensing costs. However, we cannot be certain that these costs will be recovered through the rate making process.

We are subject to credit risk.

Credit risk relates to potential losses that we would incur as a result of non-performance of contractual obligations by counterparties to deliver energy or make financial settlements. We often extend credit to counterparties and customers, and we are exposed to the risk of not being able to collect amounts owed to us. Changes in market prices may dramatically alter the size of credit risk with counterparties, even when we establish conservative credit limits. Credit risk includes potential counterparty default due to circumstances:

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

Should a counterparty, customer or supplier fail to perform, we may be required to honor the underlying commitment or to replace existing contracts with contracts at then-current market prices.

Credit risk also involves the exposure that counterparties perceive related to our ability to perform deliveries and settlement under physical and financial energy contracts. These counterparties may seek assurances of performance in the form of letters of credit, prepayment, or cash deposits.

Credit exposure can change significantly in periods of price volatility. As a result, sudden and significant demands may be made against our credit facilities and cash. Counterparties   credit exposure to us is dynamic in normal markets and may change significantly in more volatile markets. The amount of potential default risk to us, from each counterparty, depends on the extent of forward contracts, unsettled transactions and market prices. There is a risk that we may seek additional collateral from counterparties that are unable or unwilling to provide the collateral.

Our energy resource management activities may cause volatility in our cash flows and results of operations.

We engage in active hedging and resource optimization practices; however, we cannot and do not attempt to fully hedge our energy resource assets or our forecasted net positions for various time horizons. To reduce energy cost volatility and economic exposure related to commodity price fluctuations, we routinely enter into contracts to hedge a portion of our purchase and sale commitments for electricity and natural gas, as well as forecasted excess or deficit energy positions and inventories of natural gas. We use physical energy contracts and derivative instruments, such as forwards, futures, swaps and options traded in the over-the-counter markets or on exchanges. We do not cover the entire market price volatility exposure for our forecasted net positions. To the extent we have unhedged positions, or if hedging positions do not fully match the corresponding purchase or sale, fluctuating commodity prices could have a material effect on our operating revenues, resource costs, derivative

assets and liabilities, and operating cash flows. In addition, actual loads and resources typically vary from forecasts, sometimes to a significant degree, which requires additional transactions or dispatch decisions that impact cash flows.

Risk management procedures may not prevent losses.

We have a risk management policy and control procedures designed to mitigate energy market risks. However, our risk management policy and control procedures cannot prevent material losses in all possible situations or from all potential causes. As a result, there can be no assurance that our risk management procedures will prevent losses that could negatively affect our operating revenues, resource costs, derivative assets and liabilities, and operating cash flows.

Downgrades in our credit ratings could limit our ability to obtain financing, adversely affect the terms of financing and impact our ability to acquire energy resources.

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In late 2007 and early 2008, we restored an overall corporate investment grade credit rating with the two major credit rating agencies. Our credit ratings were downgraded during the fourth quarter of 2001, which resulted in an overall corporate credit rating that was below investment grade. The downgrades were due to liquidity concerns primarily related to the significant amount of purchased power and natural gas costs that we incurred in our utility operations. These downgrades increased our debt service costs. Any future downgrades could limit our ability to access capital markets or obtain other financing on reasonable terms. In addition, future downgrades could require us to provide letters of credit and/or collateral to lenders and counterparties.

An increase in interest rates could negatively affect our future results of operations and cash flows.

We expect utility capital expenditures to be over $210 million in each of 2009 and 2010. In addition to ongoing needs for our utility distribution system, significant projects include the continued enhancement of our transmission system and upgrades to generating facilities. Our forecasts indicate that we will issue new securities to fund a portion of these requirements. Rising interest rates could increase future debt service costs and decrease operating cash flows to the extent we issue new securities to fund these obligations.

We are subject to various operational and event risks that are common to the utility industry.

Our utility operations are subject to operational and event risks that include:

- blackouts or disruptions to distribution, transmission or transportation systems,
- forced outages at generating plants,
- fuel quality and availability,
- disruptions to our information systems and other administrative resources required for normal operations,
- weather conditions and natural disasters that can cause physical damage to property, requiring repairs to restore utility service, and
- terrorism and other malicious threats.

We are currently the subject of several regulatory proceedings, and we are named in multiple lawsuits related to our participation in western energy markets as disclosed in Note 26 of the Notes to Consolidated Financial Statements.

Through our utility operations and the prior operations of Avista Energy, we are involved in a number of legal and regulatory proceedings and complaints with respect to energy markets in the western United States. Most of these proceedings and complaints relate to the significant increase in the spot market price of energy in 2000 and 2001. This allegedly contributed to or caused unjust and unreasonable prices. These proceedings and complaints include, but are not limited to:

- refund proceedings in California and the Pacific Northwest,

- market conduct investigations by the FERC, and

- complaints filed by various parties related to alleged misconduct by other parties in western power markets.

As a result of these proceedings and complaints, certain parties have asserted claims for significant refunds and damages from us, which could result in a negative effect on our results of operations and cash flows. See Note 26 of the Notes to Consolidated Financial Statements for further information. Any potential refunds or obligations arising from western energy market issues (or any other contingent matters) were retained by Avista Energy as part of its asset sale agreement in June 2007.

We are subject to legislation and related administrative rulemaking which may adversely effect our operational and financial performance.

We expect to continue to be affected by legislation at the national, state and local level, as well as by administrative rules published by government agencies, such as the FERC, NERC and the EPA. Future legislation or administrative rules could have a material adverse effect on our operations, results of operations, financial condition and cash flows.

We may be affected by long-term global climate changes.

Rising concerns about long-term global climate changes could have a significant effect on our business. Changing temperatures and precipitation, including snowpack conditions, affect the availability and timing of hydroelectric

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generation capacity. Changing temperatures could also increase or decrease customer demand. We continue to monitor legislative developments at both the state and national level for the potential of further restrictions on sulfur dioxide, nitrogen oxide, carbon dioxide, as well as other greenhouse gas and mercury emissions. Our operations could be affected by changes in laws and regulations intended to mitigate the risk of global climate changes, including restrictions on the operation of our power generation resources.

Environmental laws and regulations may have the effect of:

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

As such, compliance with such environmental laws and regulations could result in increases to capital expenditures and operating expenses.

We have contingent liabilities, as disclosed in Note 26 of the Notes to Consolidated Financial Statements, and cannot predict the outcome of these matters.

We have multiple matters that are the subject of ongoing litigation, mediation, investigation and/or negotiation. We cannot predict the ultimate outcome or potential impact of any particular issue, including the extent, if any, of insurance coverage or that amounts payable by us may be recoverable through the rate making process. See Note 26 of the Notes to Consolidated Financial Statements for further details of these matters.

Other Environmental Matters

We are subject to environmental regulation by federal, state and local authorities related to our past, present and future operations. Environmental issues include, but are not limited to, contamination of certain parcels of land and waters that:

- we currently own,

we have formerly owned or have used as a customer,

are adjacent to our property,

are located on the Spokane or Clark Fork Rivers, or

are downstream of our hydroelectric facilities.

Item 1B. Unresolved Staff Comments

As of the filing date of this Annual Report on Form 10-K, we have no unresolved comments from the staff of the Securities and Exchange Commission.

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Item 2. Properties

Avista Utilities

Substantially all of our utility properties are subject to the lien of our various mortgage indentures.

Our utility electric properties, located in the states of Washington, Idaho, Montana and Oregon, include the following:

Generation Properties

	No. of Units	Nameplate Rating (MW) (1)	Present Capability (MW) (2)
Hydroelectric Generating Stations (River)			
Washington:			
Long Lake (Spokane)	4	70.0	83.3
Little Falls (Spokane)	4	32.0	34.6
Nine Mile (Spokane)	3	26.4	17.6
Upper Falls (Spokane)	1	10.0	10.2
Monroe Street (Spokane)	1	14.8	15.0
Idaho:			
Cabinet Gorge (Clark Fork)	4	265.0	254.6
Post Falls (Spokane)	6	14.8	18.0
Montana:			
Noxon Rapids (Clark Fork)	5	480.6	548.4
Total Hydroelectric		913.6	981.7
Thermal Generating Stations			
Washington:			
Kettle Falls GS	1	50.7	50.0
Kettle Falls CT	1	7.2	6.9
Northeast CT	2	61.8	56.3
Boulder Park	6	24.6	24.0
Idaho:			
Rathdrum CT	2	166.5	149.0
Montana:			
Colstrip Units 3 and 4 (3)	2	233.4	222.0
Oregon:			
Coyote Springs 2	1	287.0	278.3
Total Thermal		831.2	786.5
Total Generation Properties		1,744.8	1,768.2

(1) Nameplate Rating, also referred to as installed capacity, is the manufacturer s assigned power capability under specified conditions.
(2)

Present capability is the maximum capacity of the plant under standard test conditions without exceeding specified limits of temperature, stress and environmental conditions. Information is provided as of December 31, 2008.

(3) Jointly owned; data refers to our 15 percent interest.

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Electric Distribution and Transmission Plant

We operate approximately 18,100 miles of primary and secondary electric distribution lines providing service to retail customers. We have an electric transmission system of approximately 660 miles of 230 kV line and 1,500 miles of 115 kV line. We also own an 11 percent interest (representing 465 MW of capacity) in approximately 500 miles of a 500 kV line between Colstrip, Montana and Townsend, Montana. Our transmission and distribution system also includes numerous substations with transformers, switches, monitoring and metering devices, and other equipment.

The 230 kV lines are the backbone of our transmission grid and are used to transmit power from generation resources to the major load centers in our service area, as well as to transfer power between points of interconnection with adjoining electric transmission systems. These lines interconnect at various locations with the BPA, Grant County PUD, PacifiCorp, NorthWestern Energy and Idaho Power Company. These interconnections serve as points of delivery for power from generating facilities outside of our distribution territory, including:

- Colstrip,
- Coyote Springs 2, and
- Mid-Columbia hydroelectric generating facilities.

These lines also provide a means for us to optimize resources by entering into short-term purchases and sales of power with entities within and outside of the Pacific Northwest.

The 115 kV lines provide for transmission of energy and the integration of smaller generation facilities with our service-area load centers, including the Spokane River hydroelectric and the Kettle Falls GS. These lines interconnect with the BPA, Chelan County PUD, the Grand Coulee Project Hydroelectric Authority, Grant County PUD, NorthWestern Energy, PacifiCorp, Pend Oreille County PUD and Puget Sound Energy. Both the 115 kV and 230 kV interconnections with the BPA are used to exchange energy to facilitate service to each other s customers that are connected through the other s transmission system. We hold a long-term contract that allows us to serve our native load customers that are connected through the BPA s transmission system.

Natural Gas Plant

We have natural gas distribution mains of approximately 3,400 miles in Washington, 1,900 miles in Idaho and 2,300 miles in Oregon. The natural gas distribution system includes numerous regulator stations, service distribution lines, monitoring and metering devices, and other equipment.

We own a one-third interest in the Jackson Prairie Natural Gas Storage Project (Jackson Prairie), an underground natural gas storage field located near Chehalis, Washington. Jackson Prairie has a total peak day deliverability of 11.5 million therms, with a total working natural gas capacity of 239.5 million therms. Natural gas storage enables us to place natural gas into storage when prices are lower or to satisfy minimum natural gas purchasing requirements, as well as to meet high demand periods or to withdraw natural gas from storage when spot prices are higher.

Avista Energy controls 30.3 million therms of our capacity at Jackson Prairie and in conjunction with the asset sales agreement has assigned this capacity to Shell Energy through April 30, 2011. After that date, it is our intent to transfer this capacity to Avista Utilities for use in utility operations subject to regulatory approval.

Item 3. Legal Proceedings

See Note 26 of Notes to Consolidated Financial Statements for information with respect to legal proceedings.

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

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is currently listed on the New York Stock Exchange. As of January 31, 2009, there were 12,312 registered shareholders of our common stock.

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 generally derived from our regulated utility operations (Avista Utilities).

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.

On February 13, 2009, Avista Corp. s Board of Directors declared a quarterly dividend of $0.18 per share on the Company s common stock.

As further discussed at Note 28 of the Notes to the Consolidated Financial Statements, the IPUC accepted a stipulation that we entered with the IPUC Staff that sets forth a variety of conditions if and when we implement a holding company structure. One of the conditions would require IPUC approval of any dividend to the holding company that would reduce utility common equity below 25 percent. We entered into a similar agreement in Washington. This agreement would require WUTC approval of any dividend to the holding company that would reduce utility common equity below 30 percent. The utility equity component was approximately 47.6 percent as of December 31, 2008.

For additional information, refer to Notes 1, 23, 24 and 25 of Notes to Consolidated Financial Statements. For high and low stock prices, as well as dividend information, refer to Note 31 of Notes to Consolidated Financial Statements.

For information with respect to securities authorized for issuance under equity compensation plans, see Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

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Item 6. Selected Financial Data

	Years Ended December 31,				
(in thousands, except per share data and ratios)	2008	2007	2006	2005	2004
Operating Revenues:					
Avista Utilities	$ 1,572,664	$ 1,288,363	$ 1,267,938	$ 1,161,317	$ 972,574
Advantage IQ	59,085	47,255	39,636	31,748	23,444
Other	45,014	82,139	198,737	185,971	292,773
Intersegment Eliminations				(19,429)	(137,211)
Total	$ 1,676,763	$ 1,417,757	$ 1,506,311	$ 1,359,607	$ 1,151,580
Income (Loss) from Operations (pre-tax):					
Avista Utilities	$ 174,245	$ 150,053	$ 177,049	$ 165,101	$ 134,073
Advantage IQ	11,297	11,012	10,479	6,973	1,742
Other	(631)	(22,636)	12,032	(20,327)	4,655
Total	$ 184,911	$ 138,429	$ 199,560	$ 151,747	$ 140,470
Net Income (Loss):					
Avista Utilities	$ 70,032	$ 43,822	$ 57,794	$ 52,299	$ 32,467
Advantage IQ	6,090	6,651	6,255	3,922	577
Other	(2,502)	(11,998)	8,892	(11,233)	2,570
Net income before cumulative effect of accounting change	73,620	38,475	72,941	44,988	35,614
Cumulative effect of accounting change					(460)
Net income	$ 73,620	$ 38,475	$ 72,941	$ 44,988	$ 35,154
Average common shares outstanding, basic	53,637	52,796	49,162	48,523	48,400
Average common shares outstanding, diluted	54,028	53,263	49,897	48,979	48,886
Common shares outstanding at year-end	54,488	52,909	52,514	48,593	48,472
Earnings per Common Share, Diluted:					
Earnings before cumulative effect of accounting change	$ 1.36	$ 0.72	$ 1.46	$ 0.92	$ 0.73
Cumulative effect of accounting change					(0.01)
Total earnings per common share, diluted	$ 1.36	$ 0.72	$ 1.46	$ 0.92	$ 0.72
Total earnings per common share, basic	$ 1.37	$ 0.73	$ 1.48	$ 0.93	$ 0.73
Dividends paid per common share	$ 0.690	$ 0.595	$ 0.57	$ 0.545	$ 0.515
Book value per common share at year-end	$ 18.30	$ 17.27	$ 17.41	$ 15.82	$ 15.50
Total Assets at Year-End:					
Avista Utilities	$ 3,434,844	$ 3,009,499	$ 2,895,883	$ 2,838,154	$ 2,608,155
Advantage IQ	125,911	108,929	100,431	46,094	47,318
Other	69,992	71,369	1,060,194	2,064,246	1,056,148

Total	$ 3,630,747	$ 3,189,797	$ 4,056,508	$ 4,948,494	$ 3,711,621
Long-Term Debt (including current portion)	$ 826,465	$ 948,833	$ 976,459	$ 1,029,514	$ 986,988
Long-Term Debt to Affiliated Trusts	113,403	113,403	113,403	113,403	113,403
Preferred Stock Subject to Mandatory Redemption			26,250	28,000	29,750
Stockholders Equity	$ 996,883	$ 913,966	$ 914,525	$ 768,849	$ 751,106
Ratio of Earnings to Fixed Charges (1)	2.41	1.67	2.14	1.73	1.58

(1) See Exhibit 12 for computations.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

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

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

These statements have underlying assumptions (many of which are based, in turn, upon further assumptions). Such statements are made both in our reports filed under the Securities Exchange Act of 1934, as amended (including this Annual Report on Form 10-K), 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, p expressions.

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

- weather conditions and its effect on energy demand and generation, including the effect of precipitation and temperatures on the availability of hydroelectric resources and the effect of temperatures on customer demand and wholesale energy markets;
- global financial and economic conditions (including the availability of credit) and their effect on the Company s ability to obtain funding for working capital and long-term capital requirements on acceptable terms;

economic conditions in the Company s service areas, including the effect on the demand for, and customers ability to pay for, the Company s utility services;

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;

changes in actuarial assumptions, the interest rate environment and the actual return on plan assets for our pension plan, which can affect future funding obligations, costs and pension plan liabilities;

changes in wholesale energy prices that can affect, among other things, the cash requirements to purchase electricity and natural gas for retail customers or wholesale obligations and the market value of derivative assets and 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 effect of state and federal regulatory decisions affecting our ability to recover costs and/or earn a reasonable return including, but not limited to, the disallowance of costs that we have deferred, and the influence local economic conditions may have on the willingness of regulators to grant necessary rate increases;

the potential effects of legislation or administrative rulemaking, including the possible adoption of national or state laws requiring resources to meet certain standards and placing restrictions on greenhouse gas emissions to mitigate concerns over global climate changes;

the outcome of pending regulatory and legal proceedings arising out of the western energy crisis of 2000 and 2001, and including possible retroactive price caps and resulting refunds;

the outcome of legal proceedings and other contingencies;

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, electric retail wheeling and transmission costs;

the ability to relicense and maintain licenses for our hydroelectric generating facilities at cost-effective levels with reasonable terms and conditions;

unplanned outages at any of our generating facilities or the inability of facilities to operate as intended;

unanticipated delays or changes in construction costs, as well as our ability to obtain required operating permits for present or prospective facilities;

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- natural disasters that can disrupt energy production or delivery, as well as the availability and costs of materials and supplies and support services;
- blackouts or disruptions of interconnected transmission systems;
- the potential for terrorist attacks or other malicious acts, particularly with respect to our utility assets;
- changes in the long-term climate of the Pacific Northwest, which can affect, among other things, customer demand patterns and the volume and timing of streamflows to our hydroelectric resources;
- changes in industrial, commercial and residential growth and demographic patterns in our service territory;
- the loss of significant customers and/or suppliers;
- 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;
- increasing health care costs and the resulting effect on health insurance provided to our employees and retirees;
- increasing costs of insurance, changes in coverage terms and our ability to obtain insurance;
- employee issues, including changes in collective bargaining unit agreements, strikes, work stoppages or the loss of key executives, as well as our ability to recruit and retain employees;
- the potential effects of negative publicity regarding business practices, whether true or not, which could result in, among other things, costly litigation and a decline in our common stock price;
- changes in technologies, possibly making some of the current technology obsolete;

changes in tax rates and/or policies; 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, data contained in our records and other data available from third parties. However, there can be no assurance that our expectations, beliefs or projections will be achieved or accomplished. Furthermore, any forward-looking statement speaks only as of the date on which such statement is made. We undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances that occur after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict all of such factors, nor can we assess the effect of each such factor on our business or the extent to which any such factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

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

Potential Holding Company Formation

At the Annual Meeting of Shareholders in May 2006, the shareholders of Avista Corp. approved a proposal to proceed with a statutory share exchange, which would change the Company s organization to a holding company structure. We received approval from the FERC in April 2006 (conditioned on approval by the state regulatory agencies), the IPUC in June 2006 and the WUTC in February 2007. We also filed for approval from the utility regulators in Oregon and Montana and proceedings are pending in each of these jurisdictions. The statutory share exchange is subject to the receipt of the remaining regulatory approvals and the satisfaction of other conditions. We can not predict when the remaining regulatory approvals will be obtained or if they will be on terms acceptable to us. See further information at Note 28 of the Notes to Consolidated Financial Statements.

Business Segments

We have two reportable business segments as follows:

Avista Utilities an operating division of Avista Corp. comprising 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.

Advantage IQ an indirect subsidiary of Avista Corp. that provides sustainable utility expense management solutions, partnering with multi-site companies across North America to assess and manage utility costs and usage. Primary product lines include processing, payment and auditing of energy, telecom, waste, water/sewer and lease bills as well as strategic management services.

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In prior periods, the Company had a reportable Energy Marketing and Resource Management segment. The activities of this business segment were conducted primarily by Avista Energy. On June 30, 2007, Avista Energy and Avista Energy Canada completed the sale of substantially all of their contracts and ongoing operations to Shell Energy, as well as to certain other subsidiaries of Shell Energy. Completion of this transaction effectively ended the majority of the operations of this segment. The remaining activities do not represent a reportable business segment in 2008 and are included in the Other category for segment reporting purposes. The historical activities were reclassified to the Other category in accordance with the provisions of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. See Note 3 of the Notes to Consolidated Financial Statements for further information.

We have other businesses including sheet metal fabrication, venture fund investments and real estate investments. These activities are conducted by various indirect subsidiaries of Avista Corp., including Advanced Manufacturing and Development (AM&D), doing business as METALfx. The Other category is not a reportable segment.

Avista Energy, Advantage IQ and the various other companies are subsidiaries of Avista Capital, Inc. (Avista Capital) which is a direct, wholly owned subsidiary of Avista Corp. Our total common stockholders equity was $996.9 million as of December 31, 2008, of which $77.5 million represented our investment in Avista Capital.

The following table presents net income (loss) for each of our business segments (and the other businesses) for the year ended December 31 (dollars in thousands):

	2008	2007	2006
Avista Utilities	$ 70,032	$ 43,822	$ 57,794
Advantage IQ	6,090	6,651	6,255
Other	(2,502)	(11,998)	8,892
Net income	$ 73,620	$ 38,475	$ 72,941

Executive Level Summary

Overall

Our operating results and cash flows are primarily from:

- regulated utility operations (Avista Utilities), and
- facility information and cost management services for multi-site customers (Advantage IQ).

Our net income was $73.6 million for 2008, an increase from $38.5 million for 2007. This increase was primarily due to increased earnings at Avista Utilities (primarily due to the implementation of general rate increases in Washington and Idaho) and the $11.9 million net loss at Avista Energy (included in Other) in 2007.

Effective July 2, 2008, Advantage IQ acquired Cadence Network, a Cincinnati-based energy and expense management company. As consideration, the owners of Cadence Network received a 25 percent ownership interest in Advantage IQ. The total value of the transaction was $37 million. The acquisition of Cadence Network was funded with the issuance of Advantage IQ common stock, which is subject to redemption. Under the transaction agreement, the previous owners of Cadence Network can exercise a right to redeem their shares of Advantage IQ stock

during July 2011 or July 2012 if Advantage IQ is not liquidated through either an initial public offering or sale of the business to a third party. Their redemption rights expire July 31, 2012. The redemption price would be determined based on the fair market value of Advantage IQ at the time of the redemption election as determined by certain independent parties. Based on the estimated fair market value of Advantage IQ common stock held by the previous owners of Cadence Network, the liability was $28.8 million as of December 31, 2008 related to this potential redemption obligation.

We would like to monetize at least a portion of our investment in Advantage IQ within the next four years. The potential monetization of Advantage IQ depends on future market conditions, growth of the business and other factors. There can be no assurance that we will be able to complete a monetization event.

In late 2007 and early 2008, Moody s Investors Service and Standard & Poor s upgraded our credit ratings, which resulted in an investment grade rating for our senior unsecured debt and corporate rating from each of these rating agencies. The upgrades reflected several steps taken over the past few years to lower our business risk profile and improve financial metrics.

It is important to note that we are at the lower end of the investment grade category. We are working to continuously strengthen our credit ratings by improving earnings and operating cash flows, controlling costs and reducing the debt ratios.

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Our operations are affected by global financial and economic conditions. The instability within the financial markets has caused industry wide concern regarding the ability to access sufficient capital at a reasonable cost. The turmoil has also resulted in significant declines in the market values of assets held by pension plans (which may impact the funded status of pension plans) as well as concerns regarding credit risk.

We are observing modest declines in employment throughout our service area due to cutbacks in the construction, forest products, mining and manufacturing sectors. However, agriculture, health care, higher education and governmental sectors continue to perform well. Non-farm employment contraction for 2008 as compared to 2007 was 2.3 percent in Spokane, 2.1 percent in Medford and 4.1 percent in Coeur d Alene, compared to the national average of 2.1 percent. Unemployment rates are much higher than a year ago, having moved above the national average in our eastern Washington, northern Idaho and southern Oregon service areas. Unemployment rates for December 2008 were 7.6 percent in Spokane, 7.3 percent in Coeur d Alene and 9.9 percent in Medford, compared to the national average of 7.2 percent. The housing market has remained relatively balanced with stable prices keeping foreclosures in check. Foreclosure rates for Spokane, Coeur d Alene and Medford were all less than 0.4 percent for 2008 compared to the national average of 1.85 percent.

Avista Utilities

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

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

Our utility net income was $70.0 million for 2008, an increase from $43.8 million for 2007 partially due to an increase in gross margin (operating revenues less resource costs). The increase in gross margin was primarily due to the implementation of the general rate increases in Washington and Idaho effective January 1, 2008 and October 1, 2008, respectively. The increase in net income was also partially due to a decrease in interest expense. This was partially offset by an increase in other operating expenses. Also contributing to the increase in net income for 2008 was $5.7 million (pre-tax) of interest income, partially offset by $1.4 million (pre-tax) of interest expense, related to income tax settlements reached during the third quarter of 2008 and the resulting refunds received and payments made to the Internal Revenue Service. Additionally, the improvement in 2008 results as compared to 2007 was also due to a regulatory disallowance recorded in the third quarter of 2007.

We plan to continue to invest in generation, transmission and distribution systems with a focus on providing reliable service to our customers. Utility capital expenditures were $219.2 million for 2008. We expect utility capital expenditures to be over $210 million for 2009.

Advantage IQ

Advantage IQ had net income of $6.1 million for 2008, a decrease from $6.7 million for 2007. This was primarily due to the decrease in our ownership percentage in the business in connection with the acquisition of Cadence Network effective July 2, 2008, an increase in amortization of intangible assets (related to the Cadence acquisition) and lower short-term interest rates (which decreases interest revenue). During 2009, we

are anticipating slower internal growth at Advantage IQ than had been expected as some of their clients are experiencing bankruptcies and store closures in these difficult economic times. Additionally, interest revenue is expected to be lower in 2009 due to the historic low short-term interest rate environment that we are currently experiencing and that is expected to continue throughout 2009.

Other Businesses

Over time as opportunities arise, we plan to dispose of assets and phase out operations that do not fit with our overall corporate strategy. However, we may invest incremental funds to protect our existing investments and invest in new businesses that fit with our overall corporate strategy. The net loss for these operations was $2.5 million for 2008 compared to a net loss of $12.0 million for 2007. Contributing to the net loss in 2008 was losses on long-term venture fund investments and litigation costs. The net loss for 2007 was primarily due to Avista Energy.

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. Current conditions in the financial markets have resulted in companies having limited access to capital on reasonable terms and have resulted

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in a significant increase in borrowing rates for corporations. If we are unable to obtain capital on reasonable terms, it may limit or prohibit 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 in the total amount of $320.0 million with an expiration date of April 5, 2011. We had $250.0 million of cash borrowings and $24.3 million in letters of credit outstanding as of December 31, 2008, under our $320.0 million committed line of credit.

In November 2008, we entered into a new committed line of credit in the total amount of $200.0 million with an expiration date of November 24, 2009. We had no borrowings outstanding as of December 31, 2008, under our $200.0 million committed line of credit.

We entered into the $200.0 million line of credit to ensure we had adequate liquidity, as conditions in the financial markets resulted in limited access to capital on reasonable terms.

In March 2008, we amended our accounts receivable sales facility with Bank of America, N.A. to extend the termination date to March 2009. We expect to renew this facility before the March 2009 expiration. Under this facility, we can sell without recourse, on a revolving basis, up to $85.0 million of accounts receivable. Based upon calculations under this agreement, we had the ability to sell up to $85.0 million as of December 31, 2008. We had sold $17.0 million of accounts receivable under this facility as of December 31, 2008.

As of December 31, 2008, we had a combined $313.7 million of available liquidity under our $320.0 million committed line of credit, $200.0 million committed line of credit, and $85.0 million revolving accounts receivable sales facility.

In 2008 debt maturities were $404 million, the majority being the $273 million of 9.75 percent Unsecured Senior Notes that matured on June 1, 2008. In April 2008, we issued $250 million of 5.95 percent First Mortgage Bonds to fund a significant portion of this debt that matured. In December 2008, we issued $30 million of 7.25 percent First Mortgage Bonds due in 2013 and refinanced $17 million of Pollution Control Bonds. The proceeds from the $30 million issuance, together with funds borrowed under the $320 million committed line of credit, were used to fund $25 million of medium term notes that matured in December 2008 and to purchase $66.7 million of Pollution Control Bonds in December 2008 that we will hold until they are refunded at a later date.

We anticipate issuing long-term debt and common stock during 2009 to reduce the balances outstanding under our committed line of credit agreements. Additionally, we are planning to remarket or refund the $66.7 million of Pollution Control Bonds during 2009. We do not have any scheduled long-term debt maturities in 2009. The current portion of long-term debt includes $17 million of Pollution Control Bonds because they are subject to purchase at any time at the option of the bond holder due to the interest rate currently being reset daily. After considering the issuances of long-term debt and common stock during 2009, we expect net cash flows from operating activities and our committed line of credit agreements (total of $520.0 million) to provide adequate resources to fund:

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

In December 2006, we entered into a sales agency agreement with a sales agent to issue up to 2 million shares of our common stock from time to time. We issued 750,000 shares of common stock (total net proceeds of $16.6 million) under this sales agency agreement during the third quarter of 2008. These were our first issuances under the sales agency agreement. We plan to continue to evaluate issuing common stock in future periods.

Due to market conditions and the decline in the fair value of pension plan assets, our contributions to the pension plan in 2009 are expected to be $48 million as compared to the $28 million we contributed in 2008. The final determination of pension plan contributions beyond 2009 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 projected benefit obligation). We have adequate liquidity to meet our pension plan funding obligations for 2009.

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Avista Utilities Electric Resources

As of December 31, 2008, our generation facilities had a total net capability of 1,768 MW, of which 56 percent was hydroelectric and 44 percent was thermal. In addition to company owned generation resources, we have a number of long-term power purchase and exchange contracts that increase our available resources. See Note 7 of the Notes to Consolidated Financial Statements for information with respect to the resource optimization process.

Settlement with the Coeur d Alene Tribe

In December 2008, we reached a comprehensive agreement with the Coeur d Alene Tribe (Tribe) and the United States Department of Interior over our past and future use of Tribal land and water in the operation of our Spokane River Hydroelectric Projects, including the Post Falls dam. Pursuant to the settlement, we will compensate the Tribe a total of $39 million for past storage of water for the period from 1907 through 2007. We paid $25 million in December 2008 with remaining payments of $10 million in 2009 and $4 million in 2010. This obligation has been recorded as a regulatory asset as of December 31, 2008. We will compensate the Tribe for future storage of water through payments of $0.4 million per year beginning in 2008 and continuing through the first 20 years of a new license and $0.7 million per year through the remaining term of the license.

In addition to past and future storage payments, the agreement provides for annual payments to fund a variety of protection, mitigation and enhancement measures on the Coeur d Alene Reservation that would be implemented over the life of a new FERC license. This will be accomplished through the creation of a Coeur d Alene resource protection trust fund. Annual payments from Avista Corp. to the trust fund for protection, mitigation and enhancement measurements would commence with the issuance of the new FERC license and are expected to total approximately $100 million over an assumed 50-year license term.

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
- more closely align earned returns with those allowed by regulators.

With regards to the timing and plans for future filings, the assessment of our need for rate relief and the development of rate case plans takes into consideration short-term and long-term needs, as well as specific factors that can affect the timing of rate filings. Such factors include in-service dates of major infrastructure investments and the timing of changes in major revenue and expense items. Primarily due to the significant amount of capital investments we are making in our utility infrastructure and increasing operating costs, we filed general rate cases in Washington and Idaho in January 2009. We are planning to file in Oregon during the first half of 2009. The following is a summary of our authorized rates of return in each jurisdiction:

Jurisdiction and service	Implementation Date	Authorized Overall Rate of Return	Authorized Return on Equity	Authorized Equity Level

Washington electric and natural gas	January 2009	8.22%	10.2%	46%
Idaho electric and natural gas	October 2008	8.45%	10.2%	48%
Oregon natural gas	April 2008	8.21%	10.0%	50%

As approved by the WUTC, on January 1, 2008, electric rates for our Washington customers increased by an average of 9.4 percent, which was designed to increase annual revenues by $30.2 million. As part of this general rate increase, the base level of power supply costs used in the Energy Recovery Mechanism (ERM) calculations was updated. Also, on January 1, 2008, natural gas rates increased by an average of 1.7 percent, which was designed to increase annual revenues by $3.3 million.

In September 2008, we entered into a settlement stipulation with respect to our general rate case that was filed with the WUTC in March 2008. Other parties to the settlement stipulation are the staff of the WUTC, Northwest Industrial Gas Users, and the Energy Project. The Industrial Customers of Northwest Utilities (ICNU) joined in portions of the settlement and the Public Counsel Section of the Washington Attorney General s Office (Public Counsel) did not join in the settlement stipulation. This settlement stipulation was approved by the WUTC in December 2008. The new electric and natural gas rates became effective on January 1, 2009. As agreed to in the settlement, base electric rates for our Washington customers increased by an average of 9.1 percent, which is designed to increase annual revenues by $32.5 million. Base natural gas rates for our Washington customers increased by an average of 2.4 percent, which is designed to increase annual revenues by $4.8 million.

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Our original request in March 2008 was for base electric rate increases averaging 10.3 percent, which was designed to increase annual revenues by $36.6 million. Our original request was to increase base natural gas rates by an average of 3.3 percent, which was designed to increase annual revenues by $6.6 million.

The settlement was based on an overall rate of return of 8.22 percent with a common equity ratio of 46.3 percent and a 10.2 percent return on equity. Our original request was based on a proposed overall rate of return of 8.43 percent with a common equity ratio of 46.3 percent and a 10.8 percent return on equity.

On January 27, 2009, Public Counsel filed a Petition for Judicial Review of the WUTC s December 2008 order approving our multiparty settlement. Public Counsel raised a number of issues that were previously argued before the WUTC. These include whether settlement costs associated with resolving the dispute with the Coeur d Alene Tribe were prudent and whether recovery of such costs would constitute illegal retroactive ratemaking. Public Counsel also questioned whether the WUTC s decision to entertain supplemental testimony by us to update our filing for power supply costs during the course of the proceedings was appropriate. Finally, Public Counsel argued that the settlement improperly included advertising costs, dues and donations, and certain other expenses.

The appeal itself does not prevent the new rates from going into effect. The appeals process may take several months and a decision is not expected until later in 2009. The court will either affirm the decision of the WUTC in its entirety or reverse the decision, in whole or in part, and remand the matter back to the WUTC for further consideration, which could possibly result in refunds.

In January 2009, we filed a general rate case with the WUTC requesting to increase base electric rates for our Washington customers. In the general rate case filing, we requested a net electric rate increase of 8.6 percent. The net electric rate increase is based on a requested 16.0 percent increase in billed rates with an offsetting 7.4 percent reduction in the current Energy Recovery Mechanism (ERM) surcharge. We also requested a 2.4 percent increase in natural gas rates. The filing is designed to increase annual base electric service revenues by $69.8 million ($37.5 million net after considering the reduction in the current ERM surcharge) and increase annual natural gas service revenues by $4.9 million. Our request is based on a proposed rate of return on rate base of 8.68 percent, with a common equity ratio of 47.5 percent and an 11.0 percent return on equity. The WUTC generally has up to 11 months to review a general rate case filing.

As part of the general rate case settlement agreement that was modified and approved by the WUTC in December 2005, we agreed to increase the utility equity component to 35 percent by the end of 2007 and 38 percent by the end of 2008. Our utility equity component met this target as it was approximately 47.6 percent as of December 31, 2008.

In August 2008, we entered into an all-party settlement stipulation with respect to our general rate case that was filed with the IPUC in April 2008. This settlement stipulation was approved by the IPUC in September 2008. The new electric and natural gas rates became effective on October 1, 2008. As agreed to in the settlement, base electric rates for our Idaho customers increased by an average of 12.0 percent, which is designed to increase annual revenues by $23.2 million. Base natural gas rates for our Idaho customers increased by an average of 4.7 percent, which is designed to increase annual revenues by $3.9 million.

Our original request was for base electric rate increases averaging 16.7 percent, which was designed to increase annual revenues by $32.3 million. We also requested to increase base natural gas rates by an average of 5.8 percent, which was designed to increase annual revenues by $4.7 million.

In January 2009, we filed a general rate case with the IPUC requesting to increase base electric rates for our Idaho customers. In the general rate case filing, we requested a net electric rate increase of 7.8 percent. The net electric rate increase is based on a requested 12.8 percent increase in billed rates with an offsetting 5.0 percent reduction in the current Power Cost Adjustment (PCA) surcharge. We also requested a 3.0 percent increase in natural gas rates. The filing is designed to increase annual base electric service revenues by $31.2 million ($18.9 million net after considering the reduction in the current PCA surcharge) and increase annual natural gas service revenues by $2.7 million. Our request is based on a proposed rate of return on rate base of 8.8 percent, with a common equity ratio of 50 percent and an 11.0 percent return on equity. The IPUC generally has up to seven months to review a general rate case filing.

As approved by the OPUC in March 2008, natural gas rates for our Oregon customers increased 0.4 percent effective April 1, 2008 (designed to increase annual revenues by $0.5 million) and increased an additional 1.1 percent effective November 1, 2008 (designed to increase annual revenues by an additional $1.4 million).

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Purchased Gas Adjustments

Effective January 6, 2009, natural gas rates decreased 4.7 percent in Idaho. Effective January 16, 2009, natural gas rates decreased 3.0 percent in Washington. Effective November 1, 2008, natural gas rates decreased 4.1 percent in Oregon. Purchased gas adjustments (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. In Oregon, we absorb 10 percent of the difference between actual and projected gas costs for unhedged supply. In October 2008, the OPUC issued an order based upon an extensive review of the current PGA mechanism. The order reaffirmed the current mechanism and included several minor modifications that we believe will not have a significant impact on our gas purchasing and hedging strategies or net income. Total net deferred natural gas costs were a liability of $18.6 million as of December 31, 2008, a change from a net asset of $2.4 million as of December 31, 2007.

Oregon Senate Bill 408

The OPUC established rules in September 2007 related to Oregon Senate Bill 408 (OSB 408), which was enacted into law in 2005. These rules direct the utility to establish an automatic adjustment clause to account for the difference between income taxes collected in rates and taxes paid to units of government, net of adjustments, when that difference exceeds $100,000. The automatic adjustment clause may result in either rate increases or rate decreases and applies only to taxes paid and collected on or after January 1, 2006.

In February 2008, we reached a settlement with respect to the refund liability for the 2006 tax report that was approved by the OPUC in April 2008. The approved settlement provided for a refund to customers of $1.5 million, including interest. In October 2008, we filed the tax report for 2007 showing taxes paid to be less than taxes collected by $2.0 million before interest. We claimed that no refund should be made in connection with the 2007 tax report, asserting that such a refund would violate the fair and reasonable standard provided for under OPUC rules. In January 2009, we reached a settlement that would result in no refund related to the 2007 tax report. A joint brief related to the settlement was filed in February 2009. The OPUC is expected to rule on the settlement before April 15, 2009. We have recorded a potential refund liability related to the 2008 tax report of $1.4 million. However, any final determination of refunds or surcharges to customers will ultimately be determined based on final calculations for the 2008 tax year.

Natural Gas Decoupling

In January 2007, the WUTC approved the implementation of a natural gas decoupling mechanism. Because our rate structure provides for recovery of the majority of fixed costs on a per-therm (sales volume) basis, energy efficiency and conservation objectives have been directly at odds with the recovery of fixed costs, which do not vary with the volume of natural gas sold. Decoupling separates the direct link between natural gas sales volume and the recovery of the fixed cost of providing service to our customers. Our decoupling mechanism should allow us to recover lost margin resulting from lower usage by Washington customers due to conservation and price elasticity. However, the mechanism does not provide rate adjustments related to abnormal weather. The decoupling mechanism is a two and one half year pilot that began in January 2007. Continuation of the mechanism beyond June 2009 is subject to review and approval by the WUTC. A rate adjustment in any one year would be limited to no more than 2 percent. Our most recent decoupling rate adjustment became effective November 1, 2008. The rate adjustment is designed to recover $0.7 million from Washington residential and small commercial customers over a twelve month period. This represents an incremental rate increase of 0.3 percent, reflecting 90 percent of the lost margin due to conservation by the Company s Washington residential and small commercial gas customers during the period July 2007 through June 2008.

Wind Generation Costs

In June 2008, we filed a petition with the WUTC and the IPUC requesting that costs (including land, turbine down payments and other preliminary costs) associated with wind generation projects be accounted for as construction work in progress, allowing for the accrual of an allowance for funds used during construction (AFUDC). In July 2008, the IPUC approved our request. In December 2008, we withdrew our request in Washington and plan to address this item in a future proceeding.

Power Cost Deferrals and Recovery Mechanisms

The ERM is an accounting method used to track certain differences between actual net power supply costs and the amount included in base retail rates for our Washington customers.

This difference in net power supply costs 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.

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The initial amount of power supply costs in excess of or below the level in retail rates, which we either incur the cost of, or receive the benefit from, is referred to as the deadband. The annual (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. Through December 31, 2008, 50 percent of the annual power supply cost variance in this range was deferred for future surcharge or rebate to customers and we incurred the cost of, or received the benefit from, the remaining 50 percent. To the extent that the annual power supply cost variance from the amount included in base rates exceeds $10.0 million, 90 percent of the cost variance is deferred for future surcharge or rebate. We incur the cost of, or receive the benefit from, the remaining 10 percent of the annual variance beyond $10.0 million without affecting current or future customer rates. The following is a summary of the ERM through December 31, 2008:

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

Based upon the approved September 2008 settlement stipulation with respect to our general rate case that was filed with the WUTC in March 2008 (the settlement stipulation was approved in December 2008), the ERM was adjusted for the sharing level for the annual power supply cost variance in the $4.0 million to $10.0 million band. The adjustment resulted in 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. The 50 percent customers/50 percent Company sharing was maintained when actual power supply expenses are higher (surcharge to customers) than the amount included in base retail rates within this band. The revisions to the ERM became effective on January 1, 2009.

The following is a summary of the revised ERM:

Annual Power Supply Cost Variability	**Deferred for Future Surcharge or Rebate to Customers**	**Expense or Benefit to the Company**
+/- $0 - $4 million	0%	100%
+ between $4 million - $10 million	50%	50%
- 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 1st 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. 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. In August, 2008, the WUTC issued an order, which approved the recovery of power costs incurred for 2007. Additionally, we must make a filing (no sooner than January 1, 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.

We have a Power Cost Adjustment (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 costs deferred during the preceding July-June twelve-month period. The PCA rate surcharge, as approved by the IPUC, is 0.61 cents per KWh (designed to recover $21.7 million) for the period October 1, 2008 through September 30, 2009.

The following table shows activity in deferred power costs for Washington and Idaho during 2007 and 2008 (dollars in thousands):

	Washington	Idaho	Total
Deferred power costs as of December 31, 2006	$ 70,159	$ 9,357	$ 79,516
Activity from January 1 December 31, 2007:			
Power costs deferred	16,344	16,750	33,094
Interest and other net additions	3,023	788	3,811
Recovery of deferred power costs through retail rates	(31,002)	(5,732)	(36,734)
Deferred power costs as of December 31, 2007	$ 58,524	$ 21,163	$ 79,687

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	Washington	Idaho	Total
Activity from January 1 December 31, 2008:			
Power costs deferred	$ 7,049	$ 10,029	$ 17,078
Interest and other net additions	2,231	1,153	3,384
Recovery of deferred power costs through retail rates	(30,852)	(11,690)	(42,542)
Deferred power costs as of December 31, 2008	$ 36,952	$ 20,655	$ 57,607

Results of Operations

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

2008 compared to 2007

Utility revenues increased $284.3 million to $1,572.7 million as a result of increases in natural gas revenues of $157.0 million and electric revenues of $127.3 million. The increase in natural gas revenues was primarily the result of increased wholesale revenues (due to increased prices and volumes) of $139.5 million and retail natural gas revenues (due to increased volumes) of $16.4 million. The increase in electric revenues was primarily due to increased retail revenues (primarily due to the Washington general rate increase implemented on January 1, 2008 and the Idaho general rate increase implemented on October 1, 2008) of $58.8 million, wholesale revenues of $36.0 million and sales of fuel of $31.8 million.

Non-utility energy marketing and trading revenues decreased $36.3 million to $25.2 million. This category of revenues decreased significantly with the sale of substantially all of Avista Energy s contracts and ongoing operations on June 30, 2007. The remaining revenues primarily represent payments for the power purchase agreement for the Lancaster Plant. The majority of the rights and obligations of this agreement were assigned to Shell Energy through the end of 2009. We expect that these rights and obligations will be transferred to our regulated utility, subject to future approval by the WUTC and the IPUC.

Other non-utility revenues increased $11.0 million to $78.9 million as a result of an increase in revenues from Advantage IQ of $11.8 million primarily due to customer growth and the acquisition of Cadence Network in the third quarter of 2008, partially offset by a decrease in interest earnings on funds held for customers (due to lower interest rates).

Utility resource costs increased $251.0 million due to increases in natural gas resource costs of $147.9 million and electric resource costs of $103.1 million. The increase in natural gas resource costs primarily reflects an increase in the volume and price of natural gas purchases and increased amortization of deferred natural gas costs. The increase in electric resource costs reflects an increase in base resource costs as set forth in the Washington general rate case implemented on January 1, 2008 and the Idaho general rate case implemented on October 1, 2008, as well as higher purchased power and fuel costs.

Utility other operating expenses increased $7.8 million primarily due to an increase of $4.0 million in electric generation operating and maintenance expenses, as well as a $3.4 million increase in electric distribution expenses. This was partially offset by the impairment of a turbine in the third quarter of 2007 of $2.3 million.

Utility depreciation and amortization increased $1.8 million primarily due to additions to utility plant.

Non-utility resource costs decreased $45.1 million. This category of expenses decreased significantly with the sale of substantially all of Avista Energy s contracts and ongoing operations on June 30, 2007. The remaining costs primarily represent payments for the power purchase agreement for the Lancaster Plant. The majority of the rights and obligations of this agreement were assigned to Shell Energy through the end of 2009. We expect that these rights and obligations will be transferred to our regulated utility, subject to future approval by the WUTC and the

IPUC.

The net change in other non-utility operating expenses was a decrease of $2.7 million due to:

- a decrease of $13.2 million in the other businesses due to the sale of Avista Energy s ongoing operations, partially offset by
- an increase of $10.5 million for Advantage IQ due to expanding operations and the acquisition of Cadence Network in the third quarter of 2008.

Interest expense decreased $5.7 million due to the redemption of all outstanding preferred stock in September 2007 and the effect of long-term debt maturities during 2007 and 2008, which were primarily funded with proceeds from the sale and liquidation of Avista Energy s assets and the issuance of long-term debt at lower interest rates. This was partially offset by interest expense of $1.4 million related to an income tax settlement.

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Interest expense to affiliated trusts decreased $1.2 million due to a decrease in the variable interest rate.

Other income-net decreased $1.5 million primarily due to a decrease in interest income of $4.6 million. The decrease in interest income was primarily due to the disposition of Avista Energy s ongoing operations. Also contributing to the decrease were losses on long-term venture fund investments. The net decrease was offset by $5.7 million of interest income recorded on the IRS settlement agreement for the 2001 through 2003 tax years and the resulting refund. See Note 13 of the Notes to Consolidated Financial Statements for additional information with respect to the IRS settlement agreement.

Income taxes increased $21.3 million primarily due to increased income before income taxes. Our effective tax rate was 38.3 percent for 2008 compared to 38.7 percent for 2007.

2007 compared to 2006

Utility revenues increased $20.4 million to $1,288.4 million as a result of an increase in natural gas revenues of $56.7 million, which were the result of increased wholesale (primarily due to increased volumes) and retail (due to an increase in rates and volumes) natural gas sales. This was partially offset by a decrease in electric revenues of $36.3 million reflecting decreased wholesale revenues and sales of fuel, partially offset by increased retail revenues.

Non-utility energy marketing and trading revenues decreased $116.0 million to $61.5 million. This category of revenues decreased significantly in 2007 with the sale of substantially all of Avista Energy s contracts and ongoing operations on June 30, 2007.

Other non-utility revenues increased $7.0 million to $67.9 million as a result of an increase in revenues from Advantage IQ of $7.6 million primarily due to customer growth, as well as an increase in interest earnings on funds held for customers. This was partially offset by decreased other revenues of $0.6 million due in part to decreased sales at AM&D.

Utility resource costs increased $29.4 million due to an increase in natural gas resource costs of $54.1 million primarily reflecting an increase in the volume of natural gas purchases. The increase in natural gas resource costs was partially offset by a decrease in electric resource costs of $24.7 million primarily due to a decrease in other fuel costs (economic sales of fuel that was not used in generation) and a decrease in the net amortization of deferred power costs. The decrease in other fuel costs was consistent with reduced resource optimization activities during 2007 and lower sales of fuel and wholesale sales as part of the process of balancing loads and resources. The decrease in the net amortization of deferred power costs reflected higher electric resource costs as compared to the amount included in base electric rates and the resulting increase in deferrals for future recovery from customers. In 2007, we deferred $33.1 million of power costs as compared to $5.7 million in 2006.

Utility other operating expenses increased $11.3 million primarily due to the impairment of a turbine of $2.3 million, increased maintenance expenses of $3.5 million, natural gas distribution expenses of $1.8 million, outside services of $2.3 million, and regulatory commission fees of $2.7 million.

Utility depreciation and amortization increased $4.2 million primarily due to additions to utility plant.

Utility taxes other than income taxes increased $2.6 million primarily due to increased retail electric and natural gas revenues and related taxes.

Non-utility resource costs decreased $75.5 million. This category of expenses decreased significantly in 2007 with the sale of substantially all of Avista Energy s contracts and ongoing operations on June 30, 2007.

The net change in other non-utility operating expenses was an increase of $1.2 million due to:

- an increase of $6.8 million for Advantage IQ due to expanding operations and consulting services, and

- a decrease of $5.6 million in the other businesses due the sale of Avista Energy s ongoing operations, to lower operating expenses at AM&D and the accrual of an environmental liability at Avista Development during 2006, partially offset by the loss on the sale of Avista Energy s operations.

Interest expense decreased $9.9 million due to our issuance of fixed rate long-term debt that replaced maturing debt (which had relatively high interest rates) in the fourth quarter of 2006 and a decrease in interest expense on short-term borrowings under our committed line of credit. The decrease in short-term borrowings partially reflects the availability of funds from the Avista Energy transaction.

Capitalized interest increased $0.9 million due to increased utility construction activity and the associated increase in construction work in progress balances.

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In the Washington general rate case settlement, we agreed to write off $3.8 million of unamortized debt repurchase costs effective September 30, 2007. These costs were for premiums paid to repurchase higher coupon debt prior to its scheduled maturity as part of an effort to reduce interest expense.

Other income-net increased $2.2 million due to an increase in equity-related AFUDC (consistent with increased utility construction activity) and gains on long-term venture fund investments, partially offset by a decrease in interest income and interest on power and natural gas deferrals.

Income taxes decreased $17.7 million primarily due to decreased income before income taxes. Our effective tax rate was 38.7 percent for 2007 compared to 36.5 percent for 2006. The increase in the effective tax rate was primarily due to certain tax adjustments in 2007 and 2006. In 2007, the Company recognized tax adjustment expenses of $1.0 million. In 2006, the Company recognized adjustments related to IRS audits and adjustments for the 2005 filed federal tax return. In total, these adjustments had a favorable impact to recorded 2006 tax expense of $1.3 million.

Avista Utilities

2008 compared to 2007

Net income for the utility was $70.0 million for 2008 compared to $43.8 million for 2007. Utility income from operations was $174.2 million for 2008 compared to $150.1 million for 2007. This increase in income from operations was primarily due to increased gross margin (operating revenues less resource costs). This was partially offset by an increase in other utility operating expenses and depreciation and amortization.

The following table presents our operating revenues, resource costs and resulting gross margin for the year ended December 31 (dollars in thousands):

	Electric		Natural Gas		Total	
	2008	2007	2008	2007	2008	2007
Operating revenues	$ 838,457	$ 711,130	$ 734,207	$ 577,233	$ 1,572,664	$ 1,288,363
Resource costs	425,373	322,237	606,616	458,761	1,031,989	780,998
Gross margin	$ 413,084	$ 388,893	$ 127,591	$ 118,472	$ 540,675	$ 507,365

Utility operating revenues increased $284.3 million and utility resource costs increased $251.0 million, which resulted in an increase of $33.3 million in gross margin. The gross margin on electric sales increased $24.2 million and the gross margin on natural gas sales increased $9.1 million. The increase in our electric and natural gas gross margin was primarily due to the implementation of general rate increases in Washington effective January 1, 2008 and Idaho effective October 1, 2008. The increase was also partially due to colder weather in 2008, which increased customer usage, during the heating season and customer growth. The Company absorbed $7.4 million in 2008 and $8.5 million in 2007 under the ERM.

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

	Electric Operating Revenues		Electric Energy MWh sales	
	2008	2007	2008	2007
Residential	$ 279,641	$ 251,357	3,744	3,670
Commercial	247,714	224,179	3,188	3,132

Industrial	101,785	95,207	2,059	2,084
Public street and highway lighting	5,962	5,517	26	26
Total retail	635,102	576,260	9,017	8,912
Wholesale	141,744	105,729	1,964	1,594
Sales of fuel	44,695	12,910		
Other	16,916	16,231		
Total	$ 838,457	$ 711,130	10,981	10,506

Retail electric revenues increased $58.8 million due to an increase in:

- total MWhs sold (increased revenues $7.3 million) primarily due to customer growth and an increase in use per customer (primarily due to colder weather), and

- revenue per MWh (increased revenues $51.5 million) primarily due to the Washington general rate increase implemented on January 1, 2008 and the Idaho general rate increase implemented on October 1, 2008.

Wholesale electric revenues increased $36.0 million due to an increase in sales prices (increased revenues $9.3 million), and an increase in sales volumes (increased revenues $26.7 million).

When electric wholesale market prices are below the cost of operating our natural gas-fired thermal generating units,

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we sell the natural gas purchased for generation in the wholesale market as sales of fuel. Sales of fuel increased $31.8 million due to increased thermal generation resource optimization activities.

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

	Natural Gas Operating Revenues		Natural Gas Therms Delivered	
	2008	2007	2008	2007
Residential	$ 276,386	$ 264,546	210,125	195,756
Commercial	152,147	148,416	128,224	121,557
Interruptible	5,428	5,040	5,758	5,003
Industrial	6,731	6,244	6,438	5,830
Total retail	440,692	424,246	350,545	328,146
Wholesale	281,668	142,167	345,916	223,084
Transportation	6,327	6,638	148,723	148,765
Other	5,520	4,182	526	438
Total	$ 734,207	$ 577,2		