AVISTA CORP
Form 10-Q
November 05, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 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

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject

to such filing requirements for the past 90 days.

Yes x No ¨

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

Large accelerated filer 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

As of October 31, 2008, 54,430,678 shares of Registrant s Common Stock, no par value (the only class of common stock), were outstanding.

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FORWARD-LOOKING STATEMENTS

Our Quarterly Report on Form 10-Q contains forward-looking statements, which should be read with the cautionary statements and important factors included at Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations - Forward-Looking Statements on pages 30-31. 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. All forward-looking statements are subject to a variety of risks and uncertainties and other factors. Many of these factors are beyond our control and could have a significant effect on our operations, results of operations, financial condition or cash flows and could cause actual results to differ materially from those anticipated in our statements.

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CONSOLIDATED STATEMENTS OF INCOME (LOSS)

Avista Corporation

For the Three Months Ended September 30

Dollars in thousands, except per share amounts

	2008	2007
Operating Revenues:		
Utility revenues	$ 353,824	$ 243,798
Non-utility energy marketing and trading revenues	6,824	6,314
Other non-utility revenues	22,037	17,550
Total operating revenues	382,685	267,662
Operating Expenses:		
Utility operating expenses:		
Resource costs	245,127	144,059
Other operating expenses	49,114	50,126
Depreciation and amortization	22,023	21,551
Taxes other than income taxes	15,323	15,012
Non-utility operating expenses:		
Resource costs	6,206	6,259
Other operating expenses	18,081	13,865
Depreciation and amortization	1,479	1,054
Total operating expenses	357,353	251,926
Income from operations	25,332	15,736
Other Income (Expense):		
Interest expense	(17,452)	(19,547)
Interest expense to affiliated trusts	(1,445)	(1,836)
Capitalized interest	970	1,326
Regulatory disallowance of unamortized debt repurchase costs		(3,850)
Other income - net	7,104	2,156
Total other expense-net	(10,823)	(21,751)
Income (loss) before income taxes	14,509	(6,015)
Income taxes	7,150	(2,140)
Net income (loss)	$ 7,359	$ (3,875)
Weighted-average common shares outstanding (thousands), basic	53,773	52,834
Weighted-average common shares outstanding (thousands), diluted	54,205	52,834
Total earnings (loss) per common share, basic	$ 0.14	$ (0.07)
Total earnings (loss) per common share, diluted	$ 0.13	$ (0.07)
Dividends paid per common share	$ 0.18	$ 0.15

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF INCOME

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands, except per share amounts

	2008	2007
Operating Revenues:		
Utility revenues	$ 1,152,741	$ 926,061
Non-utility energy marketing and trading revenues	19,068	55,121
Other non-utility revenues	57,493	49,672
Total operating revenues	1,229,302	1,030,854
Operating Expenses:		
Utility operating expenses:		
Resource costs	746,428	549,565
Other operating expenses	153,353	149,358
Depreciation and amortization	65,379	63,939
Taxes other than income taxes	55,631	54,057
Non-utility operating expenses:		
Resource costs	17,661	62,372
Other operating expenses	46,426	53,173
Depreciation and amortization	3,541	3,499
Total operating expenses	1,088,419	935,963
Income from operations	140,883	94,891
Other Income (Expense):		
Interest expense	(57,131)	(60,154)
Interest expense to affiliated trusts	(4,661)	(5,463)
Capitalized interest	2,720	3,700
Regulatory disallowance of unamortized debt repurchase costs		(3,850)
Other income net	9,868	9,414
Total other expense-net	(49,204)	(56,353)
Income before income taxes	91,679	38,538
Income taxes	35,544	14,136
Net income	$ 56,135	$ 24,402
Weighted-average common shares outstanding (thousands), basic	53,366	52,769
Weighted-average common shares outstanding (thousands), diluted	53,765	53,267
Total earnings per common share, basic	$ 1.05	$ 0.46
Total earnings per common share, diluted	$ 1.04	$ 0.45
Dividends paid per common share	$ 0.510	$ 0.445

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Avista Corporation

For the Three Months Ended September 30

Dollars in thousands

	2008	2007
Net income (loss)	$ 7,359	$ (3,875)
Other Comprehensive Income (Loss):		
Unrealized losses on interest rate swap agreements - net of taxes of $(1,557)		(2,892)
Change in unfunded benefit obligation for pension plan - net of taxes of $64 and $109, respectively	119	202
Total other comprehensive income (loss)	119	(2,690)
Comprehensive income (loss)	$ 7,478	$ (6,565)

For the Nine Months Ended September 30

Dollars in thousands

	2008	2007
Net income	$ 56,135	$ 24,402
Other Comprehensive Income (Loss):		
Foreign currency translation adjustment		1,010
Reclassification adjustment for foreign currency translation adjustment included in loss on sale of contracts		(2,379)
Unrealized gains (losses) on interest rate swap agreements - net of taxes of $(2,063) and $77, respectively	(3,831)	143
Reclassification adjustment for realized losses on interest rate swap agreements deferred as a regulatory asset (included in long-term debt) - net of taxes of $5,738	10,657	
Change in unfunded benefit obligation for pension plan - net of taxes of $365 and $264, respectively	678	491
Unrealized losses on derivative commodity instruments - net of taxes of $(324)		(602)
Reclassification adjustment for realized gains on derivative commodity instruments included in net income - net of taxes of $(136)		(253)
Reclassification adjustment for realized losses on derivative commodity instruments included in loss on sale of contracts, net of taxes of $464		862
Total other comprehensive income (loss)	7,504	(728)
Comprehensive income	$ 63,639	$ 23,674

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED BALANCE SHEETS

Avista Corporation

Dollars in thousands

	September 30, 2008	December 31, 2007
Assets:		
Current Assets:		
Cash and cash equivalents	$ 15,030	$ 11,839
Restricted cash		4,068
Accounts and notes receivable-less allowances of $44,557 and $42,582	93,332	105,440
Utility energy commodity derivative assets	13,455	12,078
Regulatory asset for utility derivatives	51,151	7,171
Funds held for customers	92,429	89,885
Materials and supplies, fuel stock and natural gas stored	70,542	34,985
Deferred income taxes	16,910	20,251
Income taxes receivable	29,974	30,025
Other current assets	9,346	16,443
Total current assets	392,169	332,185
Net Utility Property:		
Utility plant in service	3,241,562	3,131,916
Construction work in progress	128,491	100,106
Total	3,370,053	3,232,022
Less: Accumulated depreciation and amortization	931,136	880,680
Total net utility property	2,438,917	2,351,342
Other Property and Investments:		
Investment in exchange power-net	26,746	28,583
Investment in affiliated trusts	13,403	13,403
Other property and investments-net	105,870	74,171
Total other property and investments	146,019	116,157
Deferred Charges:		
Regulatory assets for deferred income tax	112,087	117,461
Regulatory assets for pensions and other postretirement benefits	48,151	51,006
Other regulatory assets	41,215	43,004
Non-current utility energy commodity derivative assets	100,927	55,313
Power and natural gas deferrals	66,858	85,885
Unamortized debt expense	31,491	32,542
Other deferred charges	7,250	4,902
Total deferred charges	407,979	390,113
Total assets	$ 3,385,084	$ 3,189,797

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED BALANCE SHEETS (continued)

Avista Corporation

Dollars in thousands

	September 30, 2008	December 31, 2007
Liabilities and Stockholders Equity:		
Current Liabilities:		
Accounts payable	$ 102,917	$ 117,546
Customer fund obligations	92,429	89,885
Deposits from counterparties	16,920	12,510
Current portion of long-term debt	108,916	427,344
Short-term borrowings	86,500	
Interest accrued	22,188	12,578
Utility energy commodity derivative liabilities	64,606	19,249
Other current liabilities	100,651	84,537
Total current liabilities	595,127	763,649
Long-term debt	778,913	521,489
Long-term debt to affiliated trusts	113,403	113,403
Other Non-Current Liabilities and Deferred Credits:		
Regulatory liability for utility plant retirement costs	213,610	209,357
Non-current regulatory liability for utility derivatives	93,982	53,414
Pensions and other postretirement benefits	67,193	90,555
Deferred income taxes	464,888	440,918
Other non-current liabilities and deferred credits	79,316	83,046
Total other non-current liabilities and deferred credits	918,989	877,290
Total liabilities	2,406,432	2,275,831
Commitments and Contingencies (See Notes to Consolidated Financial Statements)		
Stockholders Equity:		
Common stock, no par value; 200,000,000 shares authorized; 54,422,099 and 52,909,013 shares outstanding	773,198	726,933
Accumulated other comprehensive loss	(12,104)	(19,608)
Retained earnings	217,558	206,641
Total stockholders equity	978,652	913,966
Total liabilities and stockholders equity	$ 3,385,084	$ 3,189,797

The Accompanying Notes are an Integral Part of These Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Avista Corporation

For the Nine Months Ended September 30

Dollars in thousands

	2008	2007
Operating Activities:		
Net income	$ 56,135	$ 24,402
Non-cash items included in net income:		
Depreciation and amortization	68,920	67,438
Provision (benefit) for deferred income taxes	5,748	(10,032)
Power and natural gas cost amortizations, net of deferrals	31,421	13,879
Amortization of debt expense	3,547	4,822
Unrealized loss on energy commodity derivatives		24,594
Regulatory disallowance of unamortized debt repurchase costs		3,850
Impairment of utility generation asset		2,290
Loss on sale of Avista Energy assets		4,254
Equity-related Allowance for Funds Used During Construction (AFUDC)	(2,892)	(3,004)
Other	(11,256)	(5,597)
Changes in working capital components:		
Accounts and notes receivable	9,336	173,586
Materials and supplies, fuel stock and natural gas stored	(35,557)	1,935
Deposits with counterparties		78,212
Other current assets	7,723	(6,560)
Accounts payable	(8,735)	(206,332)
Deposits from counterparties	4,410	(22,003)
Other current liabilities	3,111	17,859
Net cash provided by operating activities	131,911	163,593
Investing Activities:		
Utility property capital expenditures (excluding equity-related AFUDC)	(150,071)	(148,947)
Other capital expenditures	(2,627)	(2,596)
Purchase of auction rate investment securities		(130,000)
Sale of auction rate investment securities		130,000
Increase in funds held for customers	(2,544)	(125)
Decrease in restricted cash	4,068	28,585
Repayments received on notes receivable	3,010	12
Purchase of subsidiary minority interest	(8,574)	
Cash paid for acquisition of subsidiary, net of cash received	(1,428)	
Proceeds received from sale of assets	7,787	492
Changes in other property and investments	(2,925)	(3,130)
Net cash used in investing activities	(153,304)	(125,709)
Financing Activities:		
Increase (decrease) in short-term borrowings	86,500	(4,000)
Proceeds from issuance of long-term debt	249,165	
Maturity of long-term debt	(295,023)	(12,610)

Redemption of preferred stock		(26,250)
Cash dividends paid	(27,258)	(23,510)
Issuance of common stock	27,397	4,032
Cash paid for settlement of interest rate swap agreements	(16,395)	
Long-term debt and short-term borrowing issuance costs	(2,346)	(163)
Increase in customer fund obligations	2,544	125
Other		1,440
Net cash provided by (used in) financing activities	24,584	(60,936)
Net increase (decrease) in cash and cash equivalents	3,191	(23,052)
Cash and cash equivalents at beginning of period	11,839	28,242
Cash and cash equivalents at end of period	$ 15,030	$ 5,190
Supplemental Cash Flow Information:		
Cash paid during the period:		
Interest	$ 48,642	$ 47,788
Income taxes	$ 28,102	$ 28,847
Non-cash financing and investing activities:		
Change in liability to subsidiary minority shareholders	$ 26,243	$ 12,649
Issuance of subsidiary stock for acquisition of subsidiary	$ 37,100	

The Accompanying Notes are an Integral Part of These Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended September 30, 2008 and 2007 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results for the interim periods. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The Consolidated Statements of Income for the interim periods are not necessarily indicative of the results to be expected for the full year. These consolidated financial statements do not contain the detail or footnote disclosure concerning accounting policies and other matters which would be included in full fiscal year consolidated financial statements; therefore, they should be read in conjunction with the Company s audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 (2007 Form 10-K). Please refer to the section Acronyms and Terms in the 2007 Form 10-K for definitions of terms such as capacity, energy and therm.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Avista Corp. is an energy company engaged in the generation, transmission and distribution of energy as well as other energy-related businesses. Avista Utilities is an operating division of Avista Corp., comprising the regulated utility operations. Avista Utilities generates, transmits and distributes electricity in parts of eastern Washington and northern Idaho. In addition, Avista Utilities has electric generating facilities in Montana and northern Oregon. Avista Utilities also provides natural gas distribution service in parts of eastern Washington and northern Idaho, as well as parts of northeast and southwest Oregon. Avista Capital, Inc. (Avista Capital), a wholly owned subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility business segments including Avista Energy, Inc. (Avista Energy) and Advantage IQ, Inc. (Advantage IQ). Avista Energy was an electricity and natural gas marketing, trading and resource management business. On June 30, 2007, Avista Energy completed the sale of substantially all of its contracts and ongoing operations. See Note 3 for further information. Advantage IQ is a provider of facility information and cost management services for multi-site customers throughout North America. See Note 16 for business segment information.

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

- 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,
- streamflow and weather conditions that impact hydroelectric generation, utility operations and customer demand,
- market prices and supply of wholesale energy, which the Company purchases and sells, including power, fuel and natural gas,
- regulatory disallowance of the recovery of power and natural gas costs, operating costs and capital investments,
- the effects of changes in legislative and governmental regulations, including restrictions on emissions from generating plants and requirements for the acquisition of new resources,

- changes in regulatory requirements,
- availability of generation facilities, and
- competition.

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

Basis of Reporting

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

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Taxes Other Than Income Taxes

Taxes other than income taxes include state excise taxes, city occupational and franchise taxes, real and personal property taxes and certain other taxes not based on net income. These taxes are generally based on revenues or the value of property. Utility related taxes collected from customers (primarily state excise taxes and city utility taxes) are recorded as operating revenue and expense and totaled $9.3 million for the three months ended September 30, 2008 and $9.0 million for the three months ended September 30, 2007. These taxes were $40.9 million for the nine months ended September 30, 2008 and $37.7 million for the nine months ended September 30, 2007.

Other Income-Net

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Interest income	$ 1,003	$ 1,177	$ 2,837	$ 7,563
Interest on power and natural gas deferrals	820	1,059	2,960	3,287
Interest on income tax settlement	5,749		5,749	
Equity-related Allowance for Funds Used During Construction	1,034	1,076	2,892	3,004
Net gain (loss) on investments			(94)	445
Other expense	(2,224)	(1,250)	(5,462)	(5,036)
Other income	722	94	986	151
Total	$ 7,104	$ 2,156	$ 9,868	$ 9,414

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, net of tax, consisted of the following as of September 30, 2008 and December 31, 2007 (dollars in thousands):

	September 30, 2008	December 31, 2007
Unfunded benefit obligation for pensions and other postretirement benefit plans	$ (12,104)	$ (12,782)
Unrealized loss on interest rate swap agreements		(6,826)
Total accumulated other comprehensive loss	$ (12,104)	$ (19,608)

Regulatory Deferred Charges and Credits

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

rates for regulated services are established by or subject to approval by independent third-party regulators,

- the regulated rates are designed to recover the cost of providing the regulated services, and

- in view of demand for the regulated services and the level of competition, it is reasonable to assume that rates can be charged to and collected from customers at levels that will recover costs.

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

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

- required to write off its regulatory assets, and

- precluded from the future deferral of costs not recovered through rates at the time such costs are incurred, even if the Company expected to recover such costs in the future.

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The Company s primary regulatory assets include:

- power cost deferrals,
- investment in exchange power,
- regulatory asset for deferred income taxes,
- unamortized debt expense,
- assets offsetting net utility energy commodity derivative liabilities (see Note 6 for further information),
- expenditures for demand side management programs,
- expenditures for conservation programs, and
- unfunded pensions and other postretirement benefits.

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

Regulatory liabilities include:

- utility plant retirement costs,
- natural gas cost deferrals,
- settled interest rate swap agreements included as part of long-term debt, and
- liabilities offsetting net utility energy commodity derivative assets (see Note 6 for further information).

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

Reclassifications

Cash flow activity related to the $0.1 million increase in funds held for customers was reclassified as an investing activity and the $0.1 million increase in customer fund obligations was reclassified as a financing activity, rather than as operating activities as previously presented in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2007. These reclassifications had no impact on the net change in cash and cash equivalents or cash flows from operating activities for the nine months ended September 30, 2007.

NOTE 2. NEW ACCOUNTING STANDARDS

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements related to its financial assets and liabilities and nonfinancial assets and liabilities measured at fair value on a recurring basis. In February 2008, the Financial Accounting Standards Board (FASB) issued Staff Position No. 157-2, which deferred the effective date for certain portions of SFAS No. 157 related to nonrecurring measurements of nonfinancial assets and liabilities. The Company will be required to adopt those provisions of SFAS No. 157 in 2009. The adoption of the provisions of SFAS No. 157 that became effective on January 1, 2008 did not have a material impact on the Company s financial condition and results of operations; however, the Company expanded disclosures with respect to fair value measurements. See Note 12 for the expanded disclosures.

Effective January 1, 2008, the Company adopted SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This statement permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option is elected would be reported in net income. The Company did not elect to use the fair value option under SFAS No. 159 for any financial assets and liabilities at implementation and as such the adoption of SFAS No. 159 did not have any impact on its financial condition and results of operations.

Effective January 1, 2008 the Company adopted FASB Staff Position (FSP) FIN 39-1, Amendment of FASB Interpretation No. 39. FSP FIN 39-1 amends certain paragraphs of FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts, an interpretation of APB Opinion No. 10 and FASB Statement No. 105. This statement permits an entity to offset fair value amounts recognized for the right to reclaim or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. As of September 30, 2008 the Company did not offset any fair value cash collateral receivables against net derivative positions. As of December 31, 2007, the retrospective application of FSP FIN 39-1 had no impact on the Consolidated Balance Sheet. The fair value of cash collateral that was not offset in the Consolidated Balance Sheets as of September 30, 2008 and December 31, 2007 was $16.9 million and $12.5 million respectively.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. This statement replaces SFAS No. 141 and addresses the accounting for all transactions or other events in which an entity obtains control of one or more businesses. This statement requires the acquiring entity in a business combination to recognize the assets

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acquired, the liabilities assumed, and any noncontrolling interest in the transaction at the acquisition date, measured at their fair values as of that date, with limited exceptions. The Company would be required to begin applying this statement to any business combinations in 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. This statement amends Accounting Research Bulletin No. 51, Consolidated Financial Statements to establish accounting and reporting standards for a noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. This statement clarifies that a noncontrolling interest in a subsidiary is an ownership in the consolidated entity that should be reported as equity in the consolidated financial statements. The Company will be required to adopt SFAS No. 160 in 2009. The Company is evaluating the impact SFAS No. 160 will have on its financial condition and results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. This statement will require disclosure of the fair value of derivative instruments and their gains and losses in a tabular format. The statement will also require disclosure of derivative features that are related to credit risk. The Company will be required to adopt SFAS No. 161 in 2009. The Company does not expect the adoption of SFAS No. 161 to have any impact on its financial condition and results of operations. However, the Company will have expanded disclosures with respect to derivatives and hedging activities.

NOTE 3. DISPOSITION OF 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 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. Proceeds from the transaction included cash consideration for the net assets acquired by Shell Energy and the liquidation of the remaining net current assets of Avista Energy not sold to Shell Energy (primarily receivables, restricted cash and deposits with counterparties). The pre-tax net loss on the transaction was $4.3 million, which is included in non-utility other operating expenses in the Consolidated Statements of Income for the nine months ended September 30, 2007.

Certain assets of Avista Energy with a net book value of approximately $30 million were not sold or liquidated. These primarily include natural gas storage and deferred tax assets. The Company expects that the natural gas storage will ultimately be transferred to Avista Utilities, subject to future regulatory approval. The Company also expects that the power purchase agreement for the 270 megawatt (MW) natural-gas fired combined cycle combustion turbine plant located in Idaho (Lancaster Plant) for the period 2010 through 2026 will be transferred to Avista Utilities, subject to future regulatory approval.

In connection with the transaction, on June 30, 2007, Avista Energy and its affiliates entered into an Indemnification Agreement with Shell Energy and its affiliates. Under the Indemnification Agreement, Avista Energy and Shell Energy each agree to provide indemnification of the other and the other s affiliates for certain events and matters described in the purchase and sale agreement and certain other transaction agreements. Such events and matters include, but are not limited to, the refund proceedings arising out of the western energy markets in 2000 and 2001 (see Note 14), existing litigation, tax liabilities, matters with respect to natural gas storage rights, and any potential issues associated with the power purchase agreement for the Lancaster Plant. In general, such indemnification is not required unless and until a party s claims exceed $150,000 and is limited to an aggregate amount of $30 million and a term of three years (except for agreements or transactions with terms longer than three years). These limitations do not apply to certain third party claims.

Avista Energy s obligations under the Indemnification Agreement are guaranteed by Avista Capital pursuant to a Guaranty dated June 30, 2007. This Guaranty is limited to an aggregate amount of $30 million plus certain fees and expenses. Avista Capital granted Shell Energy a security interest in 50 percent of Avista Capital s common shares of Advantage IQ as collateral for its Guaranty. The aggregate obligations secured by this security interest will in no event exceed $25 million. Avista Capital may substitute collateral, such as cash or letters of credit, in place of the security interest in Advantage IQ s common shares. This security interest in Advantage IQ s common shares will terminate on December 31, 2008 except to the extent of claims actually made prior to December 31, 2008. The Guaranty will terminate April 30, 2011 except with respect to claims made prior to termination.

As of November 4, 2008, neither party has made any claims under the Indemnification Agreement or Guaranty.

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NOTE 4. ADVANTAGE IQ ACQUISITION

Effective July 2, 2008, Advantage IQ completed the acquisition of Cadence Network, Inc. (Cadence Network), a privately held, 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 $37.1 million.

The acquisition of Cadence Network was funded with the issuance of Advantage IQ common stock. Under the transaction agreement, the previous owners of Cadence Network can exercise a right to redeem their shares of Advantage IQ common 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 Company had a liability of $31.1 million as of September 30, 2008 related to this potential redemption obligation.

Advantage IQ s acquisition of Cadence Network was accounted for under the purchase method of accounting and, accordingly, the acquired assets and liabilities assumed were preliminarily recorded at their respective estimated fair values as of the date of acquisition (July 2, 2008). Significant assets recorded include the following intangible assets: goodwill of $12.8 million, client relationships of $8.6 million (estimated amortization period of 16 years) and internal use software of $3.4 million (estimated amortization period of 5 years). These intangible assets are included in other property and investments on the Consolidated Balance Sheet. Final purchase accounting is pending the completion of further review of the fair market values of relevant assets and liabilities identified as of the acquisition date. The results of operations of Cadence Network are included in the consolidated financial statements beginning in the third quarter of 2008. Pro forma disclosures reflecting the effects of the acquisition of Cadence Network are not presented, as the acquisition is not material to Avista Corp. s consolidated financial condition or results of operations.

NOTE 5. ACCOUNTS RECEIVABLE SALE

Avista Receivables Corporation (ARC) is a wholly owned, bankruptcy-remote subsidiary of Avista Corp. formed for the purpose of acquiring or purchasing interests in certain accounts receivable, both billed and unbilled, of the Company. On March 14, 2008, Avista Corp., ARC and a third-party financial institution amended a Receivables Purchase Agreement. The most significant amendment extended the termination date to March 13, 2009. Under the Receivables Purchase Agreement, ARC can sell without recourse, on a revolving basis, up to $85.0 million of those receivables. ARC is obligated to pay fees that approximate the purchaser s cost of issuing commercial paper equal in value to the interests in receivables sold. On a consolidated basis, the amount of such fees is included in other operating expenses of Avista Corp. The Receivables Purchase Agreement has financial covenants, which are substantially the same as those of Avista Corp. s $320.0 million committed line of credit (see Note 9). As of September 30, 2008, ARC had the ability to sell up to $57.0 million of receivables and there was $54.0 million in accounts receivable sold under this revolving agreement, a decrease from the $85.0 million available and sold as of December 31, 2007.

NOTE 6. ENERGY COMMODITY DERIVATIVES

Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options primarily to manage its exposure to commodity price risk. The Company uses a variety of techniques to manage risks for its energy resources and wholesale energy market activities. The Company has a risk management policy and control procedures to manage these risks, both qualitative and quantitative. The Company s Risk Management Committee establishes the Company s risk management policy and control procedures and monitors compliance. The Risk Management Committee is comprised of certain Company officers and other individuals and is overseen by the Audit Committee of the Company s Board of Directors.

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

loads at various points in time (ranging from one hour to multiple years) based on, among other things, estimates of factors such as customer usage and weather, as well as historical data and contract terms, and

resource availability at these points in time based on, among other things, estimates of streamflows, availability of generating units, historic and forward market information and experience.

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

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

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

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

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

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

Substantially all forward contracts to purchase or sell power and natural gas are recorded as assets or liabilities at market value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives under SFAS No. 133 are generally accounted for at cost until they are settled or realized, unless there is a decline in the fair value of the contract that is determined to be other than temporary. Utility energy commodity derivatives consisted of the following as of September 30, 2008 and December 31, 2007 (dollars in thousands):

	September 30, 2008	December 31, 2007
Current utility energy commodity derivative assets	$ 13,455	$ 12,078
Current utility energy commodity derivative liabilities	64,606	19,249

Net current regulatory asset	$	(51,151)	$	(7,171)
Non-current utility energy commodity derivative assets	$	100,927	$	55,313
Non-current utility energy commodity derivative liabilities		6,945		1,899
Net non-current regulatory liability	$	93,982	$	53,414

Non-current utility energy commodity derivative liabilities are included in other non-current liabilities and deferred credits on the Consolidated Balance Sheets.

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NOTE 7. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS

The Company has a defined benefit pension plan covering substantially all regular full-time employees at Avista Utilities. Individual benefits under this plan are based upon the employee s years of service and average compensation as specified in the plan. The Company s funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax purposes. The Company contributed $15 million in cash to the pension plan in each of 2007, 2006 and 2005. The Company contributed $28 million to the pension plan in 2008. The increase from the original planned contribution of $15 million was a result of the new funding rules under the Pension Protection Act of 2006 and the Company s ongoing commitment to increasing the funded status of the pension plan.

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

The Company provides certain health care and life insurance benefits for substantially all of its retired employees. The Company accrues the estimated cost of postretirement benefit obligations during the years that employees provide services. The liability and expense of this plan are included as other postretirement benefits.

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

The Company provides death benefits to beneficiaries of executive officers who die during their term of office or after retirement who were hired prior to 2008. Under the plan, an executive officer s designated beneficiary will receive a payment equal to twice the executive officer s annual base salary at the time of death (or if death occurs after retirement, a payment equal to twice the executive officer s total annual pension benefit). The liability and expense for this plan are included as other postretirement benefits.

The Company uses a December 31 measurement date for its pension and postretirement plans. The following table sets forth the components of net periodic benefit costs for the three and nine months ended September 30 (dollars in thousands):

	Pension Benefits		Other Post-retirement Benefits	
	2008	2007	2008	2007
Three months ended September 30:				
Service cost	$ 2,552	$ 2,740	$ 149	$ 160
Interest cost	5,203	4,766	469	490
Expected return on plan assets	(5,274)	(4,802)	(391)	(391)
Transition obligation recognition			126	126
Amortization of prior service cost	164	164		
Net loss recognition	800	792	(43)	57
Net periodic benefit cost	$ 3,445	$ 3,660	$ 310	$ 442
Nine months ended September 30:				
Service cost	$ 7,657	$ 8,219	$ 446	$ 480
Interest cost	15,609	14,297	1,407	1,469
Expected return on plan assets	(15,822)	(14,406)	(1,172)	(1,173)
Transition obligation recognition			379	378
Amortization of prior service cost	491	492		

Net loss recognition	2,559	2,334	201	169
Net periodic benefit cost	$ 10,494	$ 10,936	$ 1,261	$ 1,323

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NOTE 8. INCOME TAXES

The Company and its eligible subsidiaries file consolidated federal income tax returns. The Company also files state income tax returns in certain jurisdictions, including Idaho, Oregon, Montana and California. Subsidiaries are charged or credited with the tax effects of their operations on a stand-alone basis. The Internal Revenue Service (IRS) has completed its examination of the 2004 and 2005 tax years and all issues were resolved related to these years. The IRS is currently conducting an examination of the Company s 2006 and 2007 federal income tax returns. This examination could result in a change in the liability for uncertain tax positions. However, an estimate of the range of any such possible change cannot be made at this time. The Company does not believe that any open tax years with respect to state income taxes could result in any adjustments that would be significant to the consolidated financial statements.

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

Due to the revenue ruling and related regulations, the IRS has disallowed the tax deduction of indirect overhead expenses during their examination of the Company s 2001, 2002 and 2003 federal income tax returns. The Company believes that the tax deductions claimed on tax returns were appropriate based on the applicable statutes and regulations in effect at the time. Avista Corp. appealed the proposed IRS adjustment in April 2006. The Company repaid a portion of the previous tax deductions through tax payments in 2005, 2006 and 2008.

The Company estimated that its liability for unrecognized tax benefits was $22.6 million as of December 31, 2007. The liability primarily related to the indirect overhead expenses described above and was included in other non-current liabilities and deferred credits on the Consolidated Balance Sheet. The balance decreased due to the settlement of the indirect overhead expense issue. The amount did not impact the 2008 tax rate, as this deferred tax adjustment was offset by an adjustment to current income taxes payable.

On September 10, 2008, the Company entered into a Settlement Agreement (Agreement) with the Appeals Division of the IRS that would resolve all items noted during their audit of the Company s 2001 through 2003 tax years, including indirect overhead expenses. The Agreement has been approved by the Joint Committee on Taxation and is currently going through final IRS processing. The net result will be a refund to the Company of approximately $14.7 million, plus interest. Based upon the Agreement, the Company accrued an estimated $5.7 million of interest income in the third quarter of 2008, and this amount has been included in other income net in the Consolidated Statements of Income.

NOTE 9. SHORT-TERM BORROWINGS

The Company has a committed line of credit agreement with various banks in the total amount of $320.0 million with an expiration date of April 5, 2011. Under the credit agreement, the Company can request the issuance of up to $320.0 million in letters of credit. The Company had $85.0 million of borrowings outstanding as of September 30, 2008 and no borrowings outstanding as of December 31, 2007. Total letters of credit outstanding were $35.1 million as of September 30, 2008 and $34.8 million as of December 31, 2007. The committed line of credit is secured by $320.0 million of non-transferable First Mortgage Bonds of the Company issued to the agent bank that would only become due and payable in the event, and then only to the extent, that the Company defaults on its obligations under the committed line of credit.

The committed line of credit agreement contains customary covenants and default provisions, including a covenant requiring the ratio of earnings before interest, taxes, depreciation and amortization to interest expense of Avista Utilities for the preceding twelve-month period at the end of any fiscal quarter to be greater than 1.6 to 1. As of September 30, 2008, the Company was in compliance with this covenant with a ratio of 3.2 to 1. The committed line of credit agreement also has a covenant which does not permit the ratio of consolidated total debt to consolidated total capitalization of Avista Corp. to be greater than 70 percent at the end of any fiscal quarter. As of September 30, 2008, the Company was in compliance with this covenant with a ratio of 52.6 percent. If the proposed change in organization becomes effective (see Note 15), the committed line of credit will remain at Avista Corp.

In February 2008, Advantage IQ entered into a $12.5 million three-year credit agreement with a bank. Advantage IQ has the ability to increase the credit facility to $25 million under the same agreement. The credit agreement is secured by substantially all of Advantage IQ s assets. Advantage IQ had $1.5 million of borrowings outstanding under the credit agreement as of September 30, 2008.

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NOTE 10. LONG-TERM DEBT

The following details the interest rate and maturity dates of long-term debt outstanding as of September 30, 2008 and December 31, 2007 (dollars in thousands):

Maturity Year	Description	Interest Rate	September 30, 2008	December 31, 2007
2008	Secured Medium-Term Notes	6.06%-6.95%	$ 25,000	$ 45,000
2010	Secured Medium-Term Notes	6.67%-8.02%	35,000	35,000
2012	Secured Medium-Term Notes	7.37%	7,000	7,000
2013	First Mortgage Bonds	6.13%	45,000	45,000
2018	First Mortgage Bonds (1)	5.95%	250,000	
2018	Secured Medium-Term Notes	7.39%-7.45%	22,500	22,500
2019	First Mortgage Bonds	5.45%	90,000	90,000
2023	Secured Medium-Term Notes	7.18%-7.54%	13,500	13,500
2028	Secured Medium-Term Notes	6.37%	25,000	25,000
2032	Secured Pollution Control Bonds (2)	5.00%	66,700	66,700
2034	Secured Pollution Control Bonds (2)	5.13%	17,000	17,000
2035	First Mortgage Bonds	6.25%	150,000	150,000
2037	First Mortgage Bonds	5.70%	150,000	150,000
	Total secured long-term debt		896,700	666,700
2008	Unsecured Senior Notes	9.75%		272,860
2023	Unsecured Pollution Control Bonds	6.00%	4,100	4,100
	Total unsecured long-term debt		4,100	276,960
	Other long-term debt and capital leases		3,139	5,169
	Interest rate swaps		(14,563)	1,083
	Unamortized debt discount		(1,547)	(1,079)
	Total		887,829	948,833
	Current portion of long-term debt		(108,916)	(427,344)
	Total long-term debt		$ 778,913	$ 521,489

(1) On April 3, 2008, the Company issued $250.0 million of 5.95 percent First Mortgage Bonds due in 2018. The net proceeds from the issuance of $249.2 million (net of issuance discount and before Avista Corp. s expenses), together with other available funds, were used to pay the $272.9 million of 9.75 percent Unsecured Senior Notes that matured on June 1, 2008.

(2)

These Secured Pollution Control Bonds are subject to remarketing on December 30, 2008. These bonds are included in the current portion of long-term debt because, if the bonds cannot be successfully remarketed on that date, the Company will be required to purchase the bonds.

NOTE 11. INTEREST RATE SWAP AGREEMENTS

Periodically, Avista Corp. enters into forward-starting interest rate swap agreements to manage the risk associated with changes in interest rates and the impact on future interest payments. These interest rate swap agreements relate to the interest payments for the anticipated issuances of debt. These interest rate swap agreements are considered hedges against fluctuations in future cash flows associated with changes in interest rates in accordance with SFAS No. 133.

In March 2008, the Company cash settled two interest rate swap agreements and paid a total of $16.4 million. These settlements were deferred as regulatory items (part of long-term debt) and will be amortized as a component of interest expense over the remaining ten year terms of the interest rate swap agreements (forecasted interest payments) in accordance with regulatory accounting practices. The Company did not have any interest rate swap agreements outstanding as of September 30, 2008.

NOTE 12. FAIR VALUE

As disclosed in Note 2, on January 1, 2008, the Company adopted the provisions of SFAS No. 157 related to its financial assets and liabilities and nonfinancial assets and liabilities measured at fair value on a recurring basis. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

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The three levels of the fair value hierarchy defined by SFAS No. 157 are as follows:

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

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

Level 3 Pricing inputs include significant inputs that are generally unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management s best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to the Company s needs.

As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following table discloses by level within the fair value hierarchy the Company s assets and liabilities measured and reported on the Consolidated Balance Sheet as of September 30, 2008 at fair value on a recurring basis (dollars in thousands):

	Total	Counterparty Netting	Level 1	Level 2	Level 3
Assets:					
Energy commodity derivatives	$ 114,382	$ (41,067)	$	$ 25,932	$ 129,517
Deferred compensation assets	8,380		8,380		
Total	$ 122,762	$ (41,067)	$ 8,380	$ 25,932	$ 129,517
Liabilities:					
Energy commodity derivatives	$ 71,550	$ (41,067)	$	$ 91,664	$ 20,953
Deferred compensation liabilities	8,380		8,380		
Total	$ 79,930	$ (41,067)	$ 8,380	$ 91,664	$ 20,953

Avista Utilities enters into forward contracts to purchase or sell a specified amount of energy at a specified time, or during a specified period, in the future. These contracts are entered into as part of our management of loads and resources and certain contracts are considered derivative instruments. The difference between the amount of derivative assets and liabilities disclosed in respective levels and the amount of derivative assets and liabilities disclosed on the Consolidated Balance Sheets and at Note 6 is due to netting arrangements with certain counterparties. The Company uses quoted market prices and forward price curves to estimate the fair value of our utility derivative commodity instruments included in Level 2. In particular, electric derivative valuations are performed using broker quotes, adjusted for periods in between quotable periods. Natural gas derivative valuations are performed using New York Mercantile Exchange (NYMEX) pricing, adjusted for basin differences, which are also quoted under NYMEX. Where observable inputs are available for substantially the full term of the contract, the derivative asset or liability is included in Level 2. The Company also has certain contracts that, primarily due to the length of the respective contract, require the use of internally developed forward price estimates, which include significant inputs that may not be observable or corroborated in the market. These derivative contracts are included in Level 3. Refer to Note 6 for further discussion of the Company s energy commodity derivative assets and liabilities.

Deferred compensation assets and liabilities represent funds held by the Company in a Rabbi Trust for an Executive Deferral Plan. These funds consist of actively traded equity and bond funds with quoted prices in active markets. The balance disclosed excludes cash and cash equivalents of $2.0 million.

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The following table presents activity for energy commodity derivative assets measured at fair value using significant unobservable inputs (dollars in thousands):

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Balance as of beginning of the period	$ 150,971	$ 98,943
Total gains or losses (realized/unrealized)		
Included in net income		
Included in other comprehensive income		
Included in regulatory assets/liabilities (1)	(21,454)	35,556
Purchases, issuances, and settlements, net		(4,982)
Transfers to other categories		
Balance as of September 30, 2008	$ 129,517	$ 129,517

The following table presents activity for energy commodity derivative liabilities measured at fair value using significant unobservable inputs (dollars in thousands):

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Balance as of beginning of period	$ 20,310	$ 36,506
Total gains or losses (realized/unrealized)		
Included in net income		
Included in other comprehensive income		
Included in regulatory assets/liabilities (1)	645	(13,848)
Purchases, issuances, and settlements, net	(2)	