Memorandum of Negotiated Settlement Terms
October 19, 2007

This memorandum outlines the key terms of the agreement in principle reached between Avista Corporation and the State of Montana to resolve all issues pending between them in Cause No. CDV 2004-846, Mont. First Judicial District Court, Lewis & Clark County.

1. **Rent.** For purposes of settlement Avista agrees to pay rent to the State each year beginning calendar year 2007, and continuing through the remaining term of Avista's FERC license for the Clark Fork Project. Avista acknowledges that the State owns 3,158 acres of riverbed within the Clark Fork Project. The State acknowledges that the rent represents the full market value of the State interest or estate being used by Avista in connection with its operation of the Clark Fork Project (which includes both the Noxon Rapids project, and that portion of the Cabinet Gorge project within Montana). Rent will be paid in arrears, with payment due on or before each February 1 for the previous calendar year. The initial amount of the rent will be $4 million per year. The rent will be adjusted each year as follows:

a. Beginning with calendar year 2008, and continuing through calendar year 2016, the base amount of $4 million per year shall be adjusted upward by the Consumer Price Index (CPI) annual average for the calendar year for which payment is due.

b. Not later than June 30, 2016, the parties will meet and confer to determine whether the annual rental remains consistent with the principles of law as applied to the facts. In the event either party believes the annual rental no longer is consistent with applicable law applied to the facts, the parties will negotiate in good faith to determine an appropriate adjusted rental rate. If the parties do not agree upon an adjusted rental rate by September 30, 2016, the parties will engage in advisory arbitration and submit the arbitrator's recommendation to the State Board of Land Commissioners ("Land Board") for approval.

2. **Lease Terms.** The parties agree to jointly recommend to the Land Board a lease of a power site pursuant to the provisions of the Hydroelectric Resources Act, Mont. Code Ann. §§ 77-4-201, *et seq.* As part of that recommendation, the State and Avista agree to stipulate that the rent agreed upon by the parties represents full market value for the lease of 3,158 acres of Clark Fork riverbed being used by Avista in connection with the Clark Fork Project. The duration of the lease will be not less than the remaining term of Avista's FERC license.

3. **Most Favored Nations Clause.** If co-party PPL Montana, LLC, either by litigation through judgment and any appeals, or through settlement, receives a determination that the full market value of its land interests at issue in the litigation is based upon factors more favorable to it than those contained in the settlement with

Avista, the Avista rent will be adjusted by an amount necessary to reflect the more favorable determination. For purposes of this clause, a more favorable determination will occur if the aggregate annual rent determined by settlement or litigation for PPL Montana ("Determined PPL Rent") is less than 48% of the aggregate amount of base year rent ("Claimed PPL Rent") claimed by the State in its case in chief at trial. If this occurs, the $4 million base rent to be paid by Avista shall be reduced retroactively starting on the date of final judgment on the PPL Montana claims or settlement by a percentage equal to the Determined PPL Rent divided by the Claimed PPL Rent. See Attachment A for an illustration of the calculation.

4. **Reopener for Subsequent Governmental Action.** If, during the term of the Avista lease, the Land Board, the Montana Legislature, the Department of Natural Resources and Conservation, or any other State entity with jurisdiction, enacts or adopts a rental statute, rule, or policy applicable to leases issued under the Hydroelectric Resources Act that would result in a rent payment more favorable to Avista than the rent calculated under paragraph 1, the rent paid by Avista shall be modified retroactively starting on the date of enactment or adoption to incorporate the more favorable terms.

5. **Reopener for Subsequent Judicial Determination.** If, during the term of the Avista lease, the reach of the Clark Fork River within the boundaries of Avista's FERC license is determined by a court of competent jurisdiction to be not navigable for title purposes, Avista's obligation to pay rent shall cease. If, during the term of the Avista lease, a court of competent jurisdiction determines that (a) the shared net benefits method is not a lawful method to calculate the full market value of land interests; or (b) no compensation or reduced compensation in the nature of rentals is owed to the State of Montana for occupancy of state-owned riverbeds, and the application of such determination or determinations would result in a rent payment more favorable to Avista than the rent calculated under paragraph 1, or otherwise extinguish Avista's obligation to pay rentals, Avista's obligation to pay rent will be modified retroactively starting on the date of determination to reflect a method of calculating rent that is consistent with the court determination or determinations, or Avista's obligation to pay rent shall cease, accordingly.

6. **Consent Decree.** The parties will agree on the form for, and jointly move the entry as a final judgment of, a consent decree that: (a) incorporates the terms of this Memorandum; (b) contains full releases of Avista and the State for all matters at issue in the litigation; (c) allows for appropriate public notice and comment; (d) certifies that Avista is in full compliance with the terms of the Hydroelectric Resources Act; and (e) includes appropriate other terms such as dispute resolution, force majeure and so forth.

STATE OF MONTANA

By: ANTHONY JOHNSTONE, ASST. A.G.

Date: OCT. 19, 2007

AVISTA CORPORATION

By: David Meyer, V.P. & Chief Counsel for Regulatory/Government Affairs

Date: 10/19/07

ATTACHMENT A

If the Determined PPL Rent is less than 48% of the Claimed PPL Rent, Avista annual rent shall be recalculated according to following formula:

Annual Recalculated Avista Rental = A x (D ÷ C) Where:

A = $8,416,510 (Amount of annual rent claimed by the State in the State's Contention 9.A of the Pretrial Order)

D = Determined PPL Rent

C = Claimed PPL Rent set forth in State's case in chief

As an illustration, if Determined PPL Rent is $3,000,000, and the Claimed PPL Rent is $7,252,804, the Annual Avista Rental would be calculated as follows:

Annual Recalculated Avista Rental: $3,481,347 = $8,416,510 x ($3,000,000 ÷$7,252,804)