BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. AVU-E-01-11

DIRECT TESTIMONY OF RONALD R. PETERSON
REPRESENTING AVISTA CORPORATION

Q. Please state your name, business address and present position with Avista Corporation ("Avista").

A. My name is Ronald R. Peterson, and my business address is East 1411 Mission Avenue, Spokane Washington. I am employed by Avista Corporation as Vice President and Treasurer.

Q. Would you briefly describe your educational and professional background?

A. I began my career at Avista Corp. in 1975 after graduating from Washington State University with a degree in business administration, majoring in accounting. I passed the Washington State CPA examination in 1976 and worked as a staff accountant in a variety of positions until 1987, when I became Supervisor of the Company's Corporate Accounting function. In 1991, I was selected Customer Service Manager, and in 1992 was elected Treasurer. I was elected Controller and assumed the Director of Information Services responsibilities in 1996. In 1998, I was elected Vice President and Treasurer.

Q. What is the scope of your testimony?

A. I will discuss in more detail the need for the proposed PCA increase in light of existing bank covenants, the need to finance the Coyote Springs II project, and the need to maintain investment grade credit ratings.

Q. Without a PCA increase, will the Company be able to meet its bank covenants and what are the consequences if it does not?

A. Projected ratios under the current bank line covenants are shown on page 1 of Exhibit No. ___ (RRP-1). Columns C and D of the projections show that without the proceeds from the anticipated sale of common stock and the Coyote Springs II construction loan, the Company will be in violation of covenants under the line of credit, specifically the fixed charge ratio, by September 30 of this year, and would continue to be in violation throughout 2002. Not meeting the covenants would be an event of default under the current credit agreement. In this event (absent any extraordinary concessions by banks), the Company would be required to repay any outstanding borrowings under the line of credit and would be precluded from borrowing any additional amounts to the future. This would eliminate a critical external source of liquidity the Company needs to fund expenditures on a current basis. Columns G and H show the same ratios if we receive a PCA increase and complete the financing under our current plan. A PCA increase would increase the likelihood of being able to complete the needed financing. As can be seen, the Company would not be in violation of covenants in that case. It is critical to note that the Company will not be able to complete any financing with banks absent substantial progress toward recovery of the deferral balances, including an immediate increase in rates.

Q. Did the Company anticipate meeting the covenants when it entered into its current credit agreement?

A. Yes. The corporate credit facility covenants were based on projections developed in early May 2001. Those projections, based on the best information available at the time, showed that the deferral balances would be virtually recovered by February 2003, and the Company was able to meet all covenants. These projections and covenants were required by banks as a condition for renewal of our corporate line of credit in May 2001.

Q. What specifically has changed that would cause the Company to not meet the covenants in 2001?

A. The covenant that the Company would not meet is a "fixed charge" coverage test. Under this covenant, during 2001 the Company's <u>cash</u> earnings over a twelve-month period plus cash on hand must be greater than or equal to (ie. at least one times) the cash interest charges for the same period. Deferred energy costs are considered a non-cash source of earnings and therefore cannot be included in the calculation of the coverage ratio. Increasing deferrals (as a result of increases in cash expended for power and a decrease in cash expected to be received from the sale of surplus power) have reduced the amount of cash earnings available to cover the interest charges so that the ratio is below one times. In addition, the inability to complete planned financing has eliminated all cash on hand.

Q. What would be the impact on <u>customers</u> if the Company failed to meet these covenants?

A. The Company could not access bank lines, commercial paper, or debt markets unless it meets required financial covenants. The PCA balances and the additional cash required to fund power purchase commitments to meet customer needs for the remainder of 2001 have grown so large (as compared to the size of the Company) that the Company cannot continue to issue debt. Continued issuance of debt could cause the Company to violate other covenants related to the maximum debt ratio allowed (60%) under the credit arrangement. As shown on page 5, column (d) of Exhibit No. __ (RRP-1), the projected debt ratios, without a PCA increase and the planned issuance of common stock would be 59.8% by the end of 2001.

In the absence of a PCA increase or other increased revenue mechanism, the

Company is unable to generate enough cash to continue to operate the Company, including funding committed power purchases, constructing planned power resources and other facilities, and meeting our various cash requirements for debt service. In this case, the Company's ability to operate and acquire power in the future would be hampered, which would ultimately impact the cost to provide service to our customers.

Q. What should the debt-equity ratio for Avista Corp. be?

A. The Company has targeted a debt-equity ratio of 50% total debt and 50% total equity, including a mix of common and preferred stock. As shown on page 2 of Exhibit No. __ (RRP-1), to achieve this ratio would require reduction of $220 million in debt and a corresponding increase in equity of $220 million.

Our plans to fund the Company for the next 18 months include the issuance of additional common stock in 2002, and the reduction of debt through maturities.

Q. How have investor concerns impacted the Company's ability to finance on reasonable terms?

A. Investor concerns surrounding cash flows, deferral balances and the ability to recover costs in a timely manner have already had an impact on the Company's financing. In April of this year, the Company issued $400 million of Senior Unsecured Notes. As a result of these investor concerns, the notes were issued at a spread over Treasuries of nearly 500 basis points, which is significantly higher than the Company has ever paid before, and much higher than other comparably-rated securities issued during the same time period. The notes also included terms and ongoing covenants that had not been required of the Company in the past and that limit the Company's financing flexibility. In addition, when the Company renegotiated its corporate short-term credit facility in May 2001, a new fixed charge coverage ratio covenant was required by the banks in order to close the transaction. While such coverage ratio tests are not unusual, they were imposed on Avista for the first time due to the Company's weakened cash position.

Q. Didn't the proceeds of the $400 million note offering cover anticipated needs?

A. The Company expected that the proceeds of the $400 million note offering, along with $120 million construction financing for Coyote Springs II ($93 million to be invested in 2001), and the sale of $67 million of common equity in the third quarter of 2001 would cover the Company's cash needs through the middle of 2002. However, the changes that have occurred since the notes were issued have hampered the Company's ability to complete planned financing. As of mid-July 2001, the entire proceeds of the note offering had been used and the Company began borrowing under its line of credit in late July. As late as May of this year, the Company had not expected to need to use the line of credit at all in 2001.

Q. What has changed, and what specifically is the impact on Coyote Springs II?

A. As outlined in Mr. Norwood's testimony, since late May of 2001 the outlook has changed dramatically. Deferral balances are not only continuing to grow but – without prompt and significant intervention – are not expected to decline over the next 18 months. These latest projections were provided to banks who had previously received credit approval to underwrite the Coyote Springs II construction financing. Since the projections have changed so dramatically, the banks have told Avista that they will not complete the construction financing of Coyote Springs II based on the Company's current credit risk. In a letter the Company received from a bank on July 13, 2001 it stated:

> Specifically, the Avista corporate credit risk must be less than it is today if you are to receive any significant degree of financial leverage on the CS2 project. Regulatory certainty regarding rate increases and the full recovery of electric and gas deferrals is an absolute prerequisite to any financing.

Absent the construction financing for Coyote Springs II, the Company would need to borrow significant amounts under the corporate credit facility to finance Coyote Springs II. However, based on current projections for the bank line covenants, without the construction financing for Coyote Springs II, the Company would be precluded from borrowing under the credit facility since it would not meet the coverage tests. Given the latest projections, the Company will not be able to obtain conventional construction financing for this project from commercial banks without the assurance of near-term cash recovery of deferred energy costs.

Q. Has the Company considered alternative financing approaches for Coyote Springs II?

A. Yes, we are currently exploring other financing methods. These alternatives generally include non-banking investors that expect to earn higher returns. At this point these alternatives, although more costly, are the best approach for completing the financing in a timely manner. However, completion of this financing only provides short-term funds and does nothing to address the cash flow issue associated with power cost deferrals.

Q. How will the current projections impact the Company's plans to sell common stock?

A. The Company has planned to sell common stock this fall to provide a portion of the external funds needed. Financial advisors have told the Company that projections showing that Avista may be unable to borrow under its bank credit line will make it very difficult, if not impossible, to sell common stock at a reasonable price and in the time period the Company had planned. Access to additional common equity is an integral part of the financing plans that will enable Avista to continue to operate effectively through the end of 2001 and into 2002. In order that Avista may have access to the debt markets, it must also issue common stock such that its debt to equity ratio remains balanced, in a range that is expected by utility debt investors.

Q. Will the approval of a PCA increase have any impact on the Company's credit rating?

A. Yes, if a PCA increase is not approved, it is highly likely that there will be a significant downgrade of the Company's credit ratings. Page 3 of Exhibit No. __ (RRP-1) is a copy of a news release regarding Avista issued by Moody's on July 26, 2001. In the release Moody's stated :

> Fixed income investors should remain wary that, absent significant levels of support from regulators to implement the rate surcharges, Avista's cash flow would be subject to further extreme pressure and jeopardize its ability to finance its operations at a reasonable cost because of the heightened credit risk that would exist. Among the credit concerns would be Avista's potential inability to meet certain financial covenants in bank credit agreements, which would preclude access to bank funds. Under this scenario, the prospects for a precipitous downgrade of Avista's ratings would be highly likely.

Moody's went on to say:

> Moody's believes that regulatory support for the surcharges requested would go a long way toward helping stabilize credit quality, subject to satisfactory prudency determinations expected to be dealt with as part of a base rate proceeding later this year. Moody's also notes that regulatory support would improve Avista's ability to access both debt and equity capital at a reasonable cost. With regard to financing efforts, Avista remains committed to financing the remainder of construction costs associated with Coyote Springs II and to issuing common equity. Success in these endeavors would provide further stabilizing influence on Avista's credit profile.

Q. How will deteriorating financial ratios affect the Company's credit rating?

A. The Company currently has an "investment grade" credit rating (BBB with a negative outlook for its senior unsecured debt). Page 4 of Exhibit No. ___(RRP-1) shows Avista's credit rating history for secured and unsecured debt. Page 5 of this Exhibit shows key financial indicators that rating agencies look at when rating a company and compares Avista's indicators over time with the requirements for certain rating categories. The ratios have been deteriorating and, without additional equity financing and improved cash flows from operations, projected 2001 financial indicators as shown in this Exhibit, pages 5-9, are not adequate to maintain an investment grade (BBB) credit rating.

Q. What are the consequences of falling below an "investment grade" rating?

A. Institutional investors such as pension fund managers are much less likely to purchase securities (in fact, some are legally precluded) with ratings below investment grade. As a result, a drop to below investment grade would have a significant impact on the Company and its customers by causing a substantial increase in borrowing costs (or in a worst-case scenario, the Company may not be able to issue securities at all) to finance the business. Exhibit No. ___ (RRP-1), pages 5-9 also shows the same indicators for 2001 and 2002 with a PCA increase and completion of planned sales of common stock. Although the indicators improve, Avista does not immediately return to investment grade levels. It is imperative that the Company be able to obtain financing for new base load resources such as Coyote Springs II, which will be an integral part of the resources needed to serve the Company's load obligations. The Company also needs to issue common stock to move financial ratios toward a level that provides a credit rating that will allow the Company to complete financing when needed and at a reasonable cost.

I believe these steps are necessary to move the Company back to a Baa1/BBB+ credit rating level, which, in my opinion, is the minimum level we must achieve to provide financing flexibility. This rating level corresponds well to ratings of other northwest energy companies, as shown on page 10 of Exhibit No. __ (RRP-1).

Q. Does that conclude your direct testimony?

A. Yes, it does.

EXH. No.________

BEFORE THE
IDAHO PUBLIC UTILITIES COMMISSION

CASE NO. AVU-E-01-11

EXHIBIT NO. ___ (RRP-1)

Avista Corp
Estimated Fixed Charge Coverage Ratio

Period	Required Ratio	Without Financings(1) and Without Surcharge		With Financings and Without Surcharge (2)		With Financings and With Surcharge	
		Calculated Ratio	Covenant Status	Calculated Ratio	Covenant Status	Calculated Ratio	Covenant Status
(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Utility Only							
June 2001	1.25	2.23	COMPLY	2.23	COMPLY	2.23	COMPLY
Sept 2001	1.25	**-1.39**	**NOT MET**	2.90	COMPLY	3.29	COMPLY
Dec 2001	1.25	**-2.42**	**NOT MET**	**1.15**	**NOT MET**	1.99	COMPLY
Mar 2002	1.50	**-2.13**	**NOT MET**	2.15	COMPLY	3.78	COMPLY
June 2002	2.00	**-0.73**	**NOT MET**	2.10	COMPLY	3.65	COMPLY
Sept 2002	2.50	**-0.20**	**NOT MET**	2.79	COMPLY	4.70	COMPLY
Dec 2002	2.50	**0.10**	**NOT MET**	3.37	COMPLY	5.48	COMPLY
Consolidated							
June 2001	1.00	1.53	COMPLY	1.53	COMPLY	1.53	COMPLY
Sept 2001	1.00	**-2.14**	**NOT MET**	2.14	COMPLY	2.52	COMPLY
Dec 2001	1.00	**-2.91**	**NOT MET**	**0.62**	**NOT MET**	1.47	COMPLY
Mar 2002	1.50	**-2.66**	**NOT MET**	1.57	COMPLY	3.19	COMPLY
June 2002	2.00	**-0.55**	**NOT MET**	2.30	COMPLY	3.84	COMPLY
Sept 2002	2.25	**0.03**	**NOT MET**	3.06	COMPLY	4.97	COMPLY
Dec 2002	2.50	**0.37**	**NOT MET**	3.69	COMPLY	5.78	COMPLY

(1) Coyote Springs II Credit Line and additional 2001 and 2002 Common Stock Issuances
(2) For information purposes only as the stated financings are not likely to occur without a surcharge

Avista Corp
Debt-Equity Ratio

	Projected - without Surcharge & Common Issuance 12-31-01 ($ in Millions)		Adjusted to Get to 50% Debt Ratio 12-31-01 ($ in Millions)		Required Change in Debt & Common Equity ($ in Millions)
Debt	$1,345	59.8%	$1,125	50.0%	($220)
Preferred Stock	143	6.4%	143	6.4%	$0
Common Stock	762	33.9%	982	43.6%	$220
Total	2,250	100.0%	2,250	100.0%	$0

Moody's Investors Service

Global Credit Research
Rating Action
26 JUL 2001

Rating Action: Avista Corp.

MOODY'S COMMENTS ON AVISTA CORPORATION'S RECENT RATE FILING

Moody's Investors Service is maintaining the negative outlook for Avista Corporation's ratings (Sr. Sec. at Baa1), following the company's recent requests for 36.9% and 14.7% rate increases in its Washington and Idaho jurisdictions, respectively. Moody's notes that the requests are in direct response to the higher than anticipated build up in energy cost deferrals at Avista, which reached $140 million as of June 30, 2001. The build up in deferrals is due to a confluence of circumstances, including the worst drought conditions in over 70 years, volatile pricing for power in the wholesale market, and other changing market conditions (e.g.; price caps imposed by the Federal Energy Regulatory Commission). With the changing market conditions, Avista can no longer wait as it originally intended to rely on the sale of excess capacity once the construction of the Coyote Springs II generation plant is completed in mid-2002, to recover its deferred energy costs. Fixed income investors should remain wary that, absent significant levels of support from regulators to implement the rate surcharges, Avista's cash flow would be subject to further extreme pressure and jeopardize its ability to finance its operations at a reasonable cost because of the heightened credit risk that would exist. Among the credit concerns would be Avista's potential inability to meet certain financial covenants in bank credit agreements, which could preclude access to bank funds. Under this scenario, the prospects for a precipitous downgrade of Avista's ratings would be highly likely.

Notwithstanding this risk, it is important to appreciate the fact that the Washington Utilities and Transportation Commission has been generally supportive of Avista's recent attempts to deal with its energy cost challenges. Furthermore, we note that the Idaho Public Utilities Commission (IPUC) has also been supportive in this regard. In particular, the IPUC support has been evident in the recent rulings relating to purchased gas trackers and tariff adjustments under the power cost adjustment mechanism in place in Idaho. Indeed, the utility's new management team, led by Gary Ely, has taken significant steps to work closely with its various constituents, including the regulators, to restore stability to the company's credit profile. Moody's believes that regulatory support for the surcharges requested would go a long way toward helping stabilize credit quality, subject to satisfactory prudency determinations expected to be dealt with as part of a base rate proceeding later this year. Moody's also notes that regulatory support would improve Avista's ability to access both debt and equity capital at a reasonable cost. With regard to financing efforts, Avista remains committed to financing the remainder of construction costs associated with Coyote Springs II and to issuing common equity. Success in these endeavors would provide further stabilizing influence on Avista's credit profile.

Avista Corporation is an energy, information, and technology company, with utility and subsidiary operations throughout North America. Its headquarters are located in Spokane, Washington.

New York
Susan D. Abbott
Managing Director
Moody's Investors Service

New York
Kevin G. Rose
Vice President - Senior Analyst
Moody's Investors Service

Avista Corp

History of Senior Secured and Unsecured Credit Ratings
As of December 31

Line No.		Fitch/Duff & Phelps		Moody's		Standard & Poor's	
		Secured	Unsecured	Secured	Unsecured	Secured	Unsecured
		(a)	(b)	(C)	(d)	(e)	(f)
	2001*						
1	**Rating**	BBB	BBB-	Baa1	Baa2	BBB+	BBB
2	**Outlook**	Stable		Negative		Negative	
3	**2000**	BBB+		Baa1	Baa2	BBB+	BBB
4	**1999**	A-	BBB+	A3	Baa1	BBB+	BBB
5	**1998**	A	A-	A3	Baa1	A	A-
6	**1997**	A	A-	A3	Baa1	A	A-
7	**1996**	A	A-	A3	Baa1	A	A-

* As of July 17, 2001

Avista Corp

Financial Indicators
1999-2002

Line No.		Actual			Projected: Without Financings or Surcharge		Projected: With Surcharge		Criteria*: Investment Grade		Criteria*: Non-Investment Grade	
		1998	1999	2000	2001	2002	2001	2002	A	BBB	BB	B
		(a)	(b)	(C)	(d)	(e)	(f)	(g)	(h)	(I)	(j)	(k)
	Internal Funds From Operations:											
1	Interest Coverage	3.4x	2.5x	2.7x	**0.9x**	2.5x	1.0x	3.5x	4.5 - 5.7x	3.1 - 4.5x	2.2 - 3.1x	1.2 - 2.2x
	Internal Funds from Operations:											
2	As a % of Debt	31.0%	16.6%	19.6%	**6.7%**	22.6%	8.6%	31.3%	31 - 39%	22 - 31%	16 - 22%	8 - 16%
	Capitalization Ratios:											
3	Debt	43.2%	54.0%	51.9%	59.8%	57.7%	55.6%	50.4%	39 - 46%	46 - 54%	**54 - 61%**	61 - 69%
4	Preferred Stock	26.1	23.4	7.6	6.3	6.3	6.5	6.3				
5	Common Equity	30.7	22.6	40.5	33.9	36.0	37.9	43.3				
	Pretax Interest Coverages:											
6	Including AFUDC and AFUCE	2.72x	1.97x	2.29x	1.59x	1.78x	1.67x	2.09x	4.0 - 5.2x	2.6 - 4.0x	1.6 - 2.6x	**0.7 - 1.6x**
7	Excluding AFUDC and AFUCE	2.67x	1.93x	2.26x	1.49x	1.71x	1.57x	2.01x				

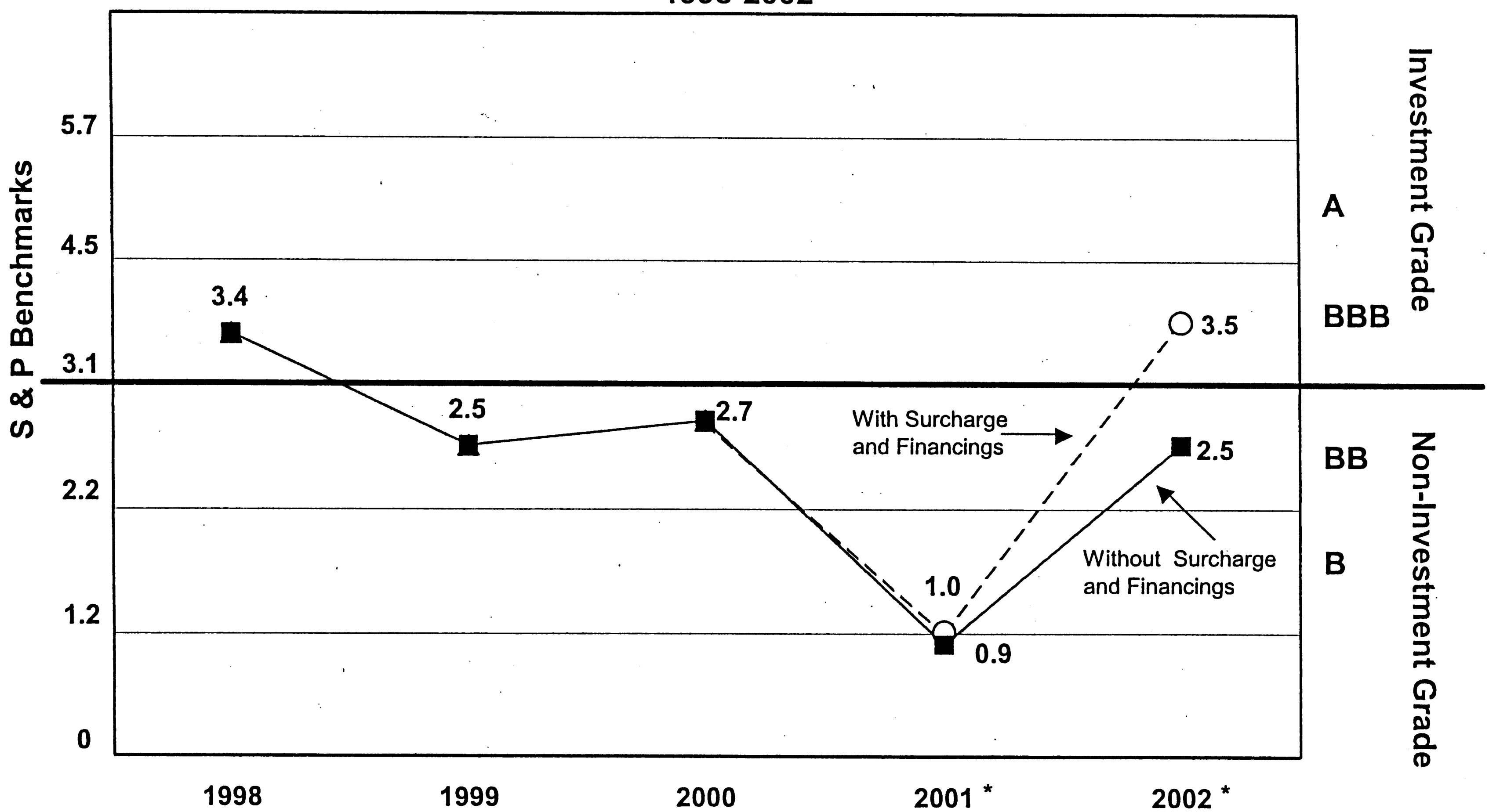
**Criteria* A, BBB, BB, B*

**Benchmarks from Standard & Poor's for Business Position "6" (Avista's current Business Position).*

Boxed area represents where Avista would be by the end of 2002 with a surcharge

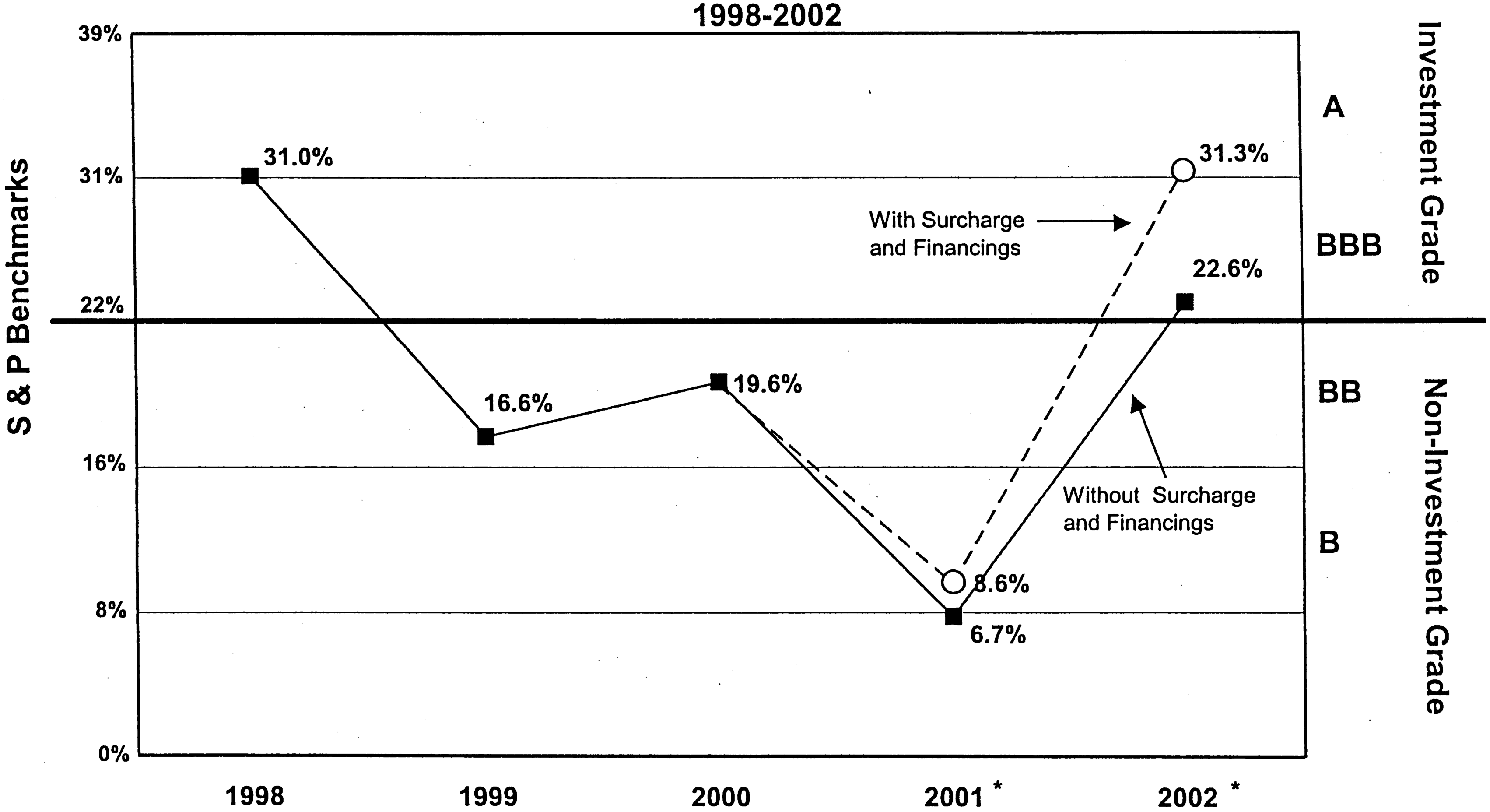
Bold area represents where Avista would be by the end of 2001 without a surcharge. Note that two of the financial indicators would be BELOW "B" rating range.

Internal Funds From Operations: Interest Coverage 1998-2002



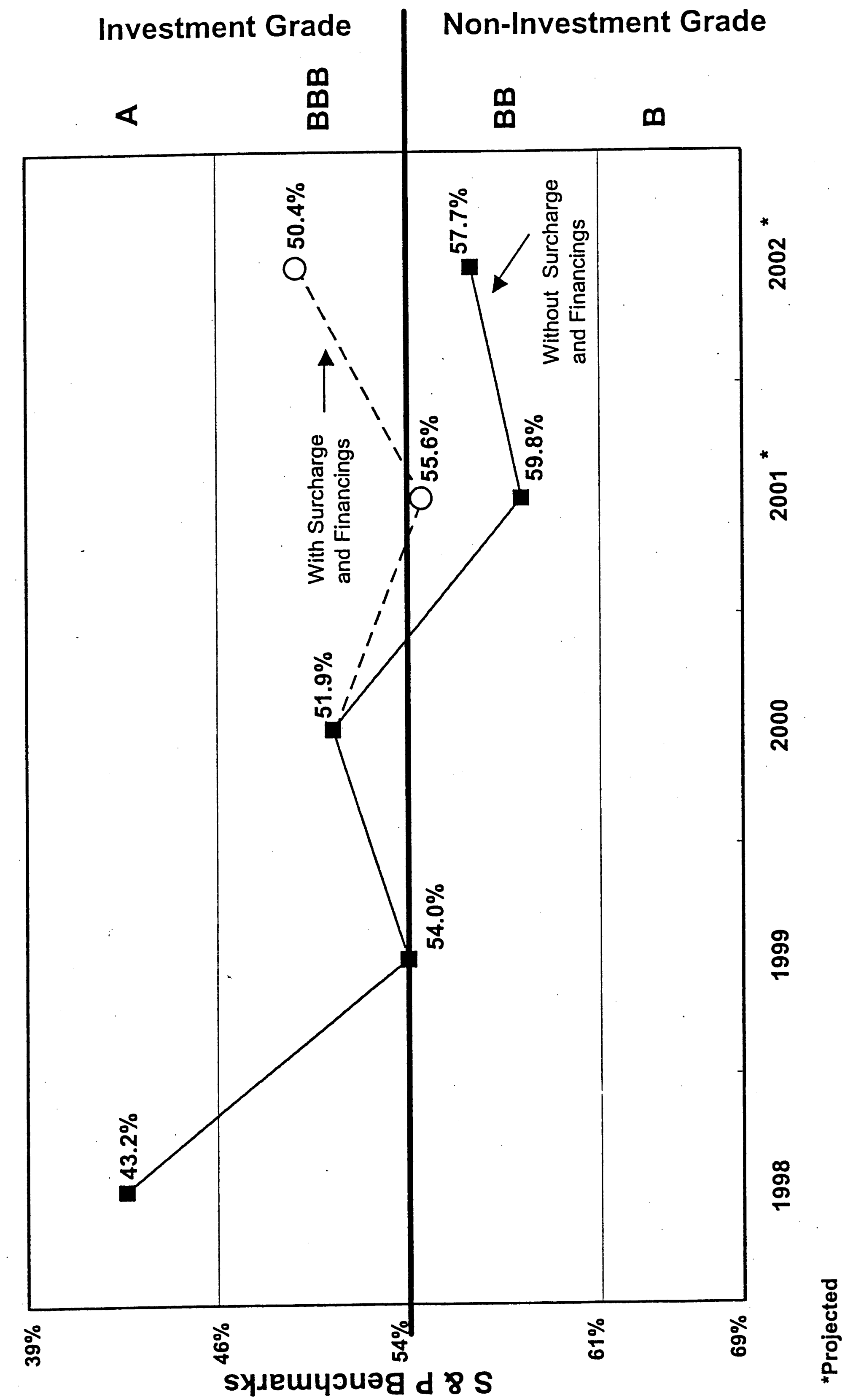
*Projected

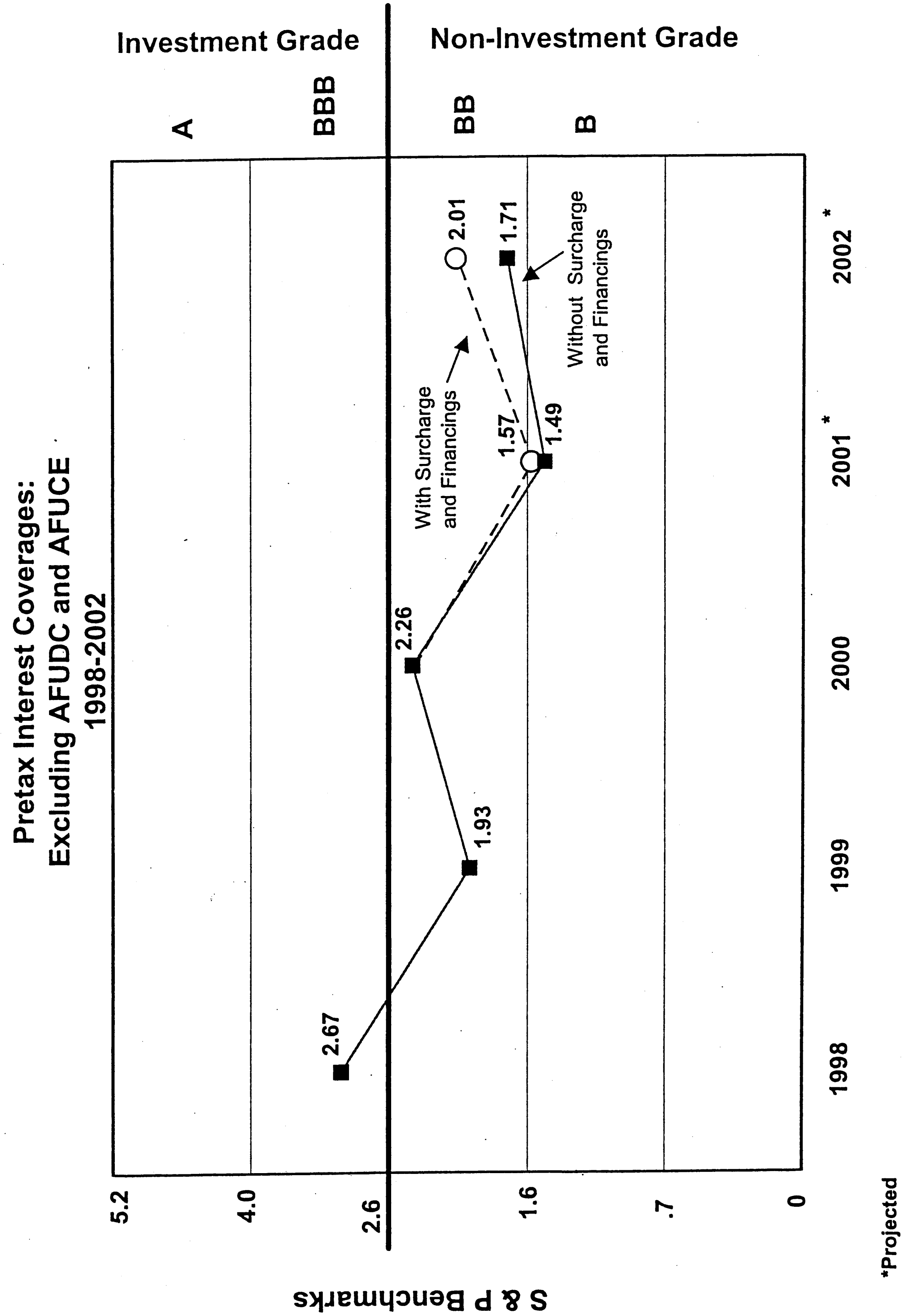
Internal Funds From Operations: As a % of Debt 1998-2002



*Projected

Debt Capitalization Ratio
1998 - 2002




Pretax Interest Coverages:
Excluding AFUDC and AFUCE
1998-2002
Investment Grade
Non-Investment Grade
A
BBB
BB
B
S & P Benchmarks
5.2
4.0
2.6
1.6
.7
0
2.67
1.93
2.26
1.57
1.49
2.01
1.71
With Surcharge
and Financings
Without Surcharge
and Financings
1998
1999
2000
2001 *
2002 *
*Projected

Senior Secured and Unsecured Credit Ratings

Line No.			Moody's		Standard & Poor's	
			Secured	Unsecured	Secured	Unsecured
			(C)	(d)	(e)	(f)
		2001				
1	Puget Sound Energy	**Rating**	Baa1	Baa2	A-	BBB+
2		**Outlook**	Negative		Negative	
3	IDACORP Inc.	**Rating**	A2	Baa1	A+	A
4		**Outlook**	Negative		Stable	
5	Montana Power Co.	**Rating**	Baa1	Baa2	A-	BBB
6		**Outlook**	Stable		Developing	
7	PacifiCorp	**Rating**	A2	A3	A+	A-
8		**Outlook**	Negative		Negative	
9	Portland General Electric Co.	**Rating**	A2	A3	A	A-
10		**Outlook**	Stable		Developing	
11	Cascade Natural Gas Corp.	**Rating**	Baa1	Baa1	BBB+	BBB+
12		**Outlook**	Stable		Negative	
13	NW Natural Gas Co.	**Rating**	A2	A3	A	A-
14		**Outlook**	Stable		Stable	