DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL OF
REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-4361

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IDAHO PUBLIC
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	CASE NO. AVU-E-09-01 CASE NO. AVU-G-09-01 DIRECT TESTIMONY OF MARK THIES

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Mark Thies. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corporation as Senior Vice President and Chief Financial Officer.

Q. Would you please describe your education and business experience?

A. I received Bachelor of Arts degrees in Accounting and Business Administration from Saint Ambrose College in Davenport, Iowa, and became a Certified Public Accountant in 1987. I have extensive experience in finance, risk management, accounting and administration within the utility sector, primarily in the Midwest.

I joined Avista in September of 2008 as Senior Vice President and Chief Financial Officer (CFO). Prior to joining Avista, I was Executive Vice President and CFO for Black Hills Corporation, a diversified energy company, providing regulated electric and natural gas service to areas of South Dakota, Wyoming and Montana. I joined Black Hills Corporation in 1997 upon leaving InterCoast Energy Company in Des Moines, Iowa, where I was the manager of accounting. Previous to that I was a senior auditor for Arthur Anderson & Co. in Chicago, Illinois.

Q. What is the scope of your testimony in this proceeding?

A. I will provide a financial overview of the Company and will explain the overall rate of return proposed by the Company in this filing for its electric and natural gas operations. The proposed rate of return is derived from Avista's long-term cost of debt and common equity, weighted in proportion to the proposed capital structure.

I will address the proposed capital structure, as well as the proposed cost of debt and equity in this filing. Company witness Dr. Avera will provide additional testimony related to the appropriate return on equity for Avista, based on the specific circumstances of the Company, together with the current state of the financial markets.

In brief, I will provide information that shows:

- Avista's plans call for significant capital expenditure requirements for the utility over the next two years to assure reliability in serving growth in the number of customers and customer demand. Capital expenditures of approximately $420 million are planned for 2009-2010 for customer growth, investment in generation, transmission and distribution facilities for the electric utility business as well as necessary maintenance and replacements of our natural gas utility systems. Avista needs adequate cash flow from operations to fund these requirements, together with access to capital from external sources under reasonable terms.

- Avista's corporate credit rating from Standard & Poor's is currently BBB- and Baa3 from Moody's. Avista Utilities needs to operate at a level that will support a strong investment grade corporate credit rating, meaning "BBB" or "BBB+", in order to access capital markets at reasonable rates, which will decrease long-term costs to customers. Maintaining solid credit metrics and credit ratings will also help support a stock price necessary to issue equity to fund capital requirements.

- The Company has proposed an overall rate of return of 8.80%, including a 50.00% equity ratio and an 11.0% return on equity. We believe the 11.0% provides a reasonable balance of the competing objectives of continuing to improve our financial health, and the impacts that increased rates have on our customers.

The Company's initiatives to carefully manage its operating costs and capital expenditures are an important part of improving performance, but are not sufficient without revenues from the general rate request for our electric and natural gas businesses in these cases. Certainty of cash flows from operations can only be achieved with the continued support of regulators in allowing the timely recovery of costs and the ability to earn a fair return on investment.

Finally, I will provide testimony concerning the Company's pension expense and its proposal for a balancing account with respect to annual dollar differences between cash payments and pension expense.

A table of contents for my testimony is as follows:

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Q. Are you sponsoring any exhibits with your direct testimony?

A. Yes. I am sponsoring Exhibit No. 2, Schedules 1 and 2, which were prepared under my direction. Avista's credit ratings by the three principal rating agencies are summarized on Schedule 1, and Avista's actual capital structure at December 31, 2008 and pro forma capital structure at June 30, 2009 are included on Schedule 2, page 1, with supporting information on pages 2 through 3.

II. FINANCIAL OVERVIEW

Q. Please provide an overview of Avista's financial situation.

A. The Company has made solid progress in improving its financial health in recent years, as demonstrated by improved financial ratios. Avista has reduced investments in unregulated subsidiaries and redeployed the majority of the proceeds from the sales of the unregulated subsidiaries to the Utility. The Company has been able to improve its debt ratio and balance the overall debt / equity ratio by paying down debt, issuing additional common stock, and through additional retained earnings. Although we have made progress in improving the Company's financial condition, we are still not as strong as we need to be given the current unrest in capital markets, which may continue for some time.

Avista's goal is to operate at a level that will support a strong corporate credit rating of BBB / BBB+, and move away from the "cliff" of the investment grade rating scale. Operating at a higher rating will help reduce long-term costs to customers. It will also reduce collateral requirements and allow us to maintain access to more counterparties for acquisition of natural gas and electricity. We expect that a continued focus on the regulated utility, conservative financing strategies (including the issuance of common equity) and a continued supportive regulatory environment will contribute to an overall improved financial situation, that will allow us to move up from the current BBB- rating.

Q. What additional steps is the Company taking to improve its financial health?

A. We are working to assure we have adequate funds for operations, capital expenditures and debt maturities. We recently acquired a new $200 million 364-day line of credit from our banks at reasonable rates that has allowed us to avoid the debt capital markets at a volatile time when rates are very high. In December 2008, we also obtained a $30 million private placement of five-year debt at favorable rates as compared to the public markets.

We are maintaining our original $320 million line of credit, which will expire in April 2011, as well as our Accounts Receivable Sales program. The Company plans to obtain a portion of our capital requirements through equity issuance. We also maintain an ongoing dialogue with the rating agencies regarding the measures taken by the Company to improve our credit rating.

Additionally, the Company is working through regulatory processes to recover our costs in a timely manner so that earned returns are closer to those allowed by regulators in each of the states we serve. This is one of the key determinants from the rating agencies' standpoint when they are reviewing our overall credit standing.

Q. In addition to having credit ratings that will allow Avista to attract debt capital under reasonable terms, is it also necessary to attract capital from equity investors?

A. It is absolutely essential. Avista has two primary sources of external capital - debt lenders and equity investors. Avista currently has approximately $2.0 billion of net investment in place to serve its customers.

Approximately half of that investment is funded by debt holders, and half is funded by equity investors. Therefore, even though there tends to be a lot of emphasis on maintaining credit metrics and credit ratings that will provide access to debt capital under reasonable terms, access to equity capital is equally important.

Additional equity capital generally comes in two forms - retained earnings and new equity issuances. Retained earnings represent the annual earnings (return on equity) of the Company that is not paid out to investors in dividends. The retained earnings are reinvested by the Company in utility plant, and other capital requirements, to serve customers, which avoids the need to issue new debt. Occasionally it is necessary to issue new common stock to maintain the proper balance of debt and equity in the capital structure, which allows Avista access to both debt and equity markets under reasonable terms, on a sustainable basis. Because of the large capital requirements at Avista in the near-term, it is imperative that Avista have ready-access to both the debt and equity markets at reasonable costs.

Q. Are the debt and equity capital markets a competitive market?

A. Yes. Our ability to attract new capital, especially equity capital, under reasonable terms is dependent on our ability to offer a risk/reward opportunity that is better than the equity investors' other alternatives. We are competing with not only other utilities, but businesses in other sectors of the economy. As an example, if an equity investor believes, or perceives, that the risk/reward opportunity is better with WalMart than with Avista, or the utility industry in general, the investor will put the equity dollars in WalMart stock. Demand for the stock supports the stock price, which provides the opportunity to issue additional stock under reasonable terms to fund capital investment requirements.

To the extent that the equity investor holds a diversified portfolio of companies that includes utilities and other energy companies, we would be competing with those companies to attract those equity dollars.

In the debt markets, utilities are the third largest issuers, right behind governments and financial services. Therefore, it is a very competitive market and the Company must be able to attract debt investors as well as equity investors.

Q. What is Avista doing to attract equity investment?

A. Avista is carrying a capital structure that provides the opportunity to have financial metrics that offer a risk/reward proposition that is competitive and/or attractive for equity holders.

We have increased our dividend for common shareholders, and have publicly stated that we intend to work toward a dividend payout ratio that is comparable to other utilities in the industry. This is an essential element in providing a competitive risk/reward opportunity for equity investors.

We are operating the business efficiently to keep costs as low as practicable for our customers, while at the same time ensuring that our energy service is reliable, and results in a high level of customer satisfaction. An efficient, well-run business is not only important to our customers, but also to investors.

We are employing tracking mechanisms such as the PCA and PGA, approved by the regulatory commissions, to balance the risk of owning and operating the business in a manner that places us in a position to offer a risk/reward opportunity that is competitive with not only other utilities, but with businesses in other sectors of the economy.

We are seeking rate relief to provide timely recovery of costs and earned returns closer to those allowed by regulators. If we are not able to achieve a reasonable, actual, earned return on our equity investment, we will not be able to attract equity dollars that are absolutely necessary to support this business going forward.

Dr. Avera provides additional testimony related to the appropriate return on equity for Avista, that would allow the Company access to equity capital under reasonable terms, and on a sustainable basis.

Q. Do you believe there are misconceptions about the earnings of the Company related to the equity investment in the Company?

A. Yes I do. I believe some of our customers believe that the earnings of the Company that we report publicly each quarter are "profits" that are over and above the dollars necessary to own and operate the utility, which we know is simply not true. Just as we must pay interest to debt holders in exchange for the use of their dollars, we must also provide a return on investment for the equity holder, or the equity holder will take his or her dollars somewhere else.

I believe some do not understand that the quarterly earnings or profits are the return or "interest" to the shareholder, and without it we would not have the funds necessary to run the business - i.e., it is, in fact, one of the essential costs of owning and operating the business.

Q. After Avista reported its earnings for the Second Quarter (Q2) of 2008, it was reported in the Spokesman Review newspaper that "Avista Quarterly Profits Soar." Did

Avista's earnings for Q2 of 2008 exceed those authorized by this Commission?

A. No. While earnings from utility operations did improve some for Q2 2008 versus the prior year, the primary reason for the improvement was that Avista Corp completed the sale of Avista Energy during Q2 2007, and recorded a large loss in Q2 2007 related to the operations of that business. The absence of the loss in 2008, resulted in a substantial improvement in reported earnings in Q2 of 2008.

Q. What do the quarterly and annual earnings reported by Avista tell us about the earned return for equity holders for 2008?

A. Although actual earnings for the calendar year 2008 have not yet been released, Avista has previously provided "guidance" for the expected earnings for the year. The current earnings guidance for Avista Utilities for 2008 is the range of $1.20 to $1.35 per common share. At September 30, 2008 Avista had approximately 54.0 million common shares outstanding, and an equity investment in the utility of $904 million, per our third-quarter 10-Q filed with the Securities and Exchange Commission. If we were to assume that Avista will see earnings in the middle of the earnings guidance, at $1.28/share, it would result in a return on investment for equity holders of 7.6%. By comparison, the currently authorized return on equity in Idaho for Avista is 10.20%. Therefore, during 2008 we expect to earn substantially less than what we were authorized to earn by the IPUC, i.e., we will not recover our costs of providing service to customers, including a competitive return to equity holders.

If we continue to fall short, it will threaten our ability to obtain financing from debt and equity holders under reasonable terms.

Q. What is the Company expecting to earn in 2009?

A. We received additional rate relief in all three states where we do business during 2008 (January 1, 2009 for Washington). While this provides additional cost recovery, we are also continuing to experience increases in costs, and increased capital investment requirements. As an example, our most recent rate case in Idaho included recovery of new capital investment through December 31, 2008, but none for 2009. What that means is, we are not recovering the costs associated with the new capital investment we have already made in 2009, and will continue to make, until the conclusion of this rate case in mid-2009.

Furthermore, if we do not reflect in retail rates the cost of future capital that will be serving customers during the period that retail rates are in place from this case, we will continue to earn a lower return than what we are authorized to earn.

We have previously announced that we expect Avista's utility earnings for 2009 to be in the range of $1.30 to $1.45 per share. If we again use the middle of the range ($1.38/share) for illustrative purposes, 54.0 million shares outstanding, and $1.0 billion of equity investment, it would result in an earned return for 2009 of 7.5%, again well below the authorized return of 10.2%.

As we process this rate filing, it is imperative that we work toward recovery of the costs to provide service to customers, and a meaningful opportunity to earn a return closer to the allowed return, so that we can have access to debt and equity capital under reasonable terms.

III. CREDIT RATINGS

Q. How important are credit ratings for Avista?

A. Utilities need ready access to capital markets in all types of economic environments. I believe few, if any, would have predicted the kind of financial markets we have experienced the past few months. The nature of our business with long-term capital projects, our obligation to serve, and the potential for high volatility in fuel and purchased power markets, necessitates the ability to tap the financial markets under reasonable terms on a regular basis.

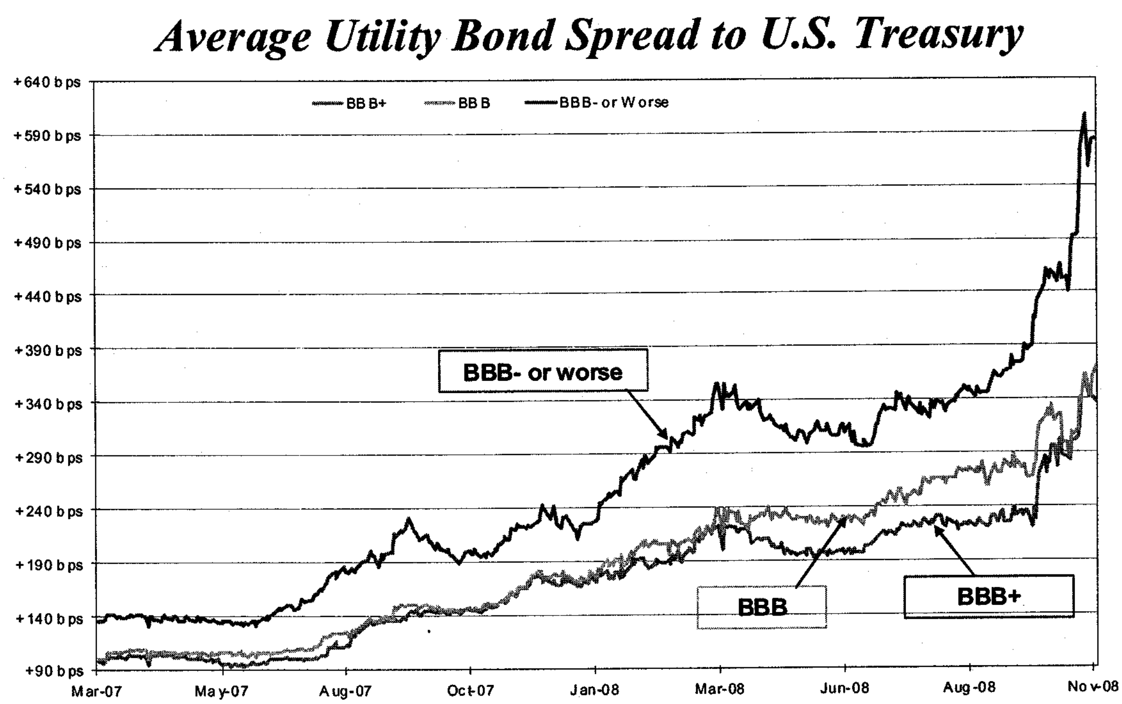
In these past few months we have seen ample evidence of the benefit of having a higher credit rating. As an example, in December, 2008, El Paso Electric, a BB credit, issued bonds at an effective cost of 15%.

In the fall of 2008 we had planned to issue an additional $100 million of long-term debt. In April 2008 we issued $250 million of 10-year debt at 5.95%. In the fall of 2008, however, because of the unrest in the financial markets, there were times when we could not issue debt at <u>any</u> interest rate, and when it was available, the all-in interest rates were 9.5% or higher. Fortunately, we were able to negotiate the acquisition of an additional credit line of $200 million for a period of 364 days, under favorable terms, and avoid issuing new long-term debt at these high rates - at least for now. We believe that financial markets will be more stable as we move toward the later part of 2009, and our financial circumstances will be such that we will have access to new long-term debt at reasonable rates.

Q. Yields on US Treasuries have decreased significantly over the past several months. Why have interest rates for utility bonds gone up?

A. Although it is true that the yield on US Treasuries has declined, the interest rate spreads between utility bonds and Treasuries that debt holders are demanding have increased dramatically due to the unrest in the financial system and the economy. The following graph illustrates the dramatic rise in the gap during 2008 between the yields on Treasuries and utility bonds rated BBB+, BBB, and BBB- or below. The graph also illustrates the significantly higher cost of debt for companies at or below the lowest rung of the investment grade ladder (BBB- or below), versus a credit rating of BBB, only one step higher than Avista's current rating of BBB-.

Illustration No. 1:



Q. Please explain the credit ratings for Avista's debt securities.

A. Rating agencies are independent agencies that assess risks for investors. The three most widely recognized rating agencies are Standard & Poor's (S&P), Moody's Investors Service (Moody's) and FitchRatings

(Fitch). These rating agencies assign a credit rating to companies and their securities so investors can more easily understand the risks associated with investing in their debt and preferred stock. Avista's credit ratings by the three principal rating agencies are summarized on page 1 of Exhibit No. 2. Additionally, the following rating actions occurred during 2007 and 2008:

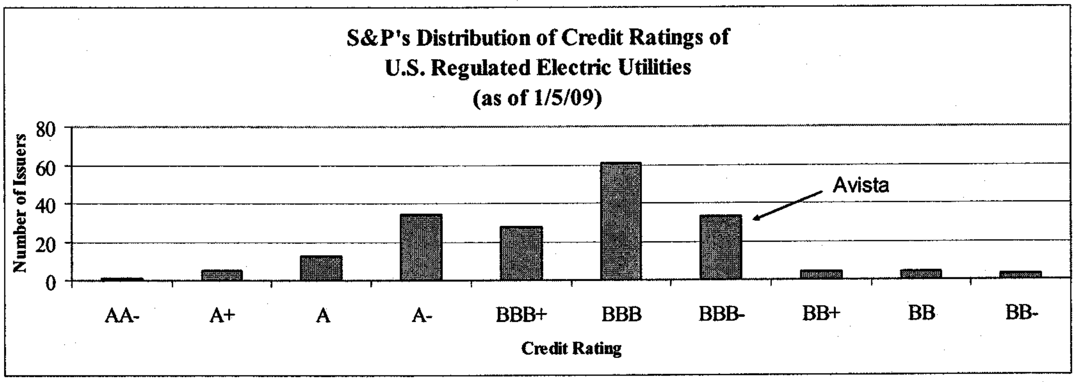
a. S&P upgraded Avista's corporate credit rating to BBB- from BB+ (February 2008) and Avista's secured debt rating to BBB+ from BBB- (September 2007 and affirmed in September 2008).

b. Moody's upgraded Avista's corporate credit rating to Baa3 from Ba1 and Avista's secured rating to Baa2 from Baa3 (December 2007).

c. Fitch upgraded Avista's long-term issuer default rating to BB+ from BB and its secured debt rating to BBB from BBB- (August 2007 and affirmed in February 2008).

As shown in Illustration No. 2 below, Avista is on the lowest rung of the investment grade credit rating scale. As I noted earlier, I believe it is important that we move up the scale to at least a BBB or BBB+, so that we are not on the edge of the investment grade cliff.

Illustration No. 2:



Q. Please explain the implications of the credit ratings in terms of the Company's ability to access financial markets.

A. Credit ratings impact investor demand and expected return. More specifically, when the company issues debt, the credit rating helps determine the interest rate at which the debt will be issued. The credit rating also determines the type of investor who will be interested in purchasing the debt. For each type of investment a potential investor could make, the investor looks at the quality of that investment in terms of the risk they are taking and the priority they would have in the event that the organization experiences severe financial stress. Investment risks include the likelihood that a company will not meet all of its debt obligations in terms of timeliness and amounts owed for principal and interest. Secured debt receives the highest ratings and priority for repayment and, hence, has the lowest relative risk. In challenging credit markets, where investors are less likely to buy corporate bonds, a higher credit rating will attract more investors, and a lower credit rating could shrink or eliminate the number of potential investors. Thus, lower credit ratings may result in a company having more difficulty accessing financial markets and/or incur significantly higher financing costs.

Q. What credit rating does Avista Corporation believe is appropriate?

A. The move to investment grade for Avista Corp last year was a significant step in improving the ability to access capital at a reasonable cost. However, a credit rating at the bottom of investment grade is not appropriate for Avista. In adverse conditions – whether unique to Avista or by all market participants – a downgrade from BBB- (investment grade) to BB+ (high-yield) is significantly harder to overcome than a downgrade from BBB to BBB-. As Avista experienced, it took approximately six years for the Company to regain its investment grade rating from S&P after it was downgraded during the energy crisis. The difference between investment grade and non-investment grade is not only a matter of debt pricing, it can be a matter of any access at all. During the period from mid-September to mid-December, the credit markets were essentially closed to non-investment grade issuers. In order to be able to weather a potential downgrade, Avista Utilities should operate at a level that will support a strong corporate investment grade credit rating, meaning a "BBB" or an "BBB+," using S&P's rating scale.

A solid investment grade credit rating would also allow the Company to post less collateral with counterparties than would otherwise be required with a lower credit rating. This results in lower costs. It also increases financial flexibility since the credit line capacity would not be reduced for outstanding letters of credit.

Financially healthy utilities have lower financing costs which, in turn, benefit customers. In addition, financially healthy utilities are better able to invest in the needed infrastructure over time to serve their customers, and to withstand the challenges and risks facing the industry.

Q. What financial metrics are used by the rating agencies to establish credit ratings?

A. S&P modified its electric and natural gas utility rankings in November 2007 to conform to the "business risk/financial risk" matrix used by their corporate ratings group. The change by S&P was designed to present their rating conclusions in a clear and standardized manner across all corporate sectors.

S&P's financial ratio benchmarks used to rate companies such as Avista are set forth in Illustration No. 3 below.

Illustration No. 3:

Standard & Poor's Financial Risk Indicative Ratios - US Utilities	FFO/Debt (%)	FFO/Interest (x)	Debt Ratio (%)
Modest	40 - 60	4.0 - 6.0	25 - 40
Intermediate	25 - 45	3.0 - 4.5	35 - 50
Aggressive	10 - 30	2.0 - 3.5	45 - 60
Highly leveraged	Below 15	2.5 or less	Over 50
12 Month End 9/30/08 Ratios:			
Avista Adjusted*	17.6	3.4	53.7

* Calculated as of 9/30/08 based on last known S&P methodology

The ratios above are utilized to determine the financial risk profile. Currently, Avista is in the "Aggressive" category. The financial risk category along with the business risk profile (Avista is in the Strong category) is then utilized in Illustration No. 4 below to determine a company's rating. S&P currently has Avista's corporate credit rating as a BBB-, as indicated in the following illustration.

Illustration No. 4:

Standard & Poor's Business Risk / Financial Risk Matrix

	Financial Risk Profile				
Business Risk Profile	Minimal	Modest	Intermediate	Aggressive	Highly leveraged
Excellent	AAA	AA	A	BBB	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-	B
Vulnerable	BB	B+	B+	B	B-

The other rating agencies (Moody's and Fitch) use a similar methodology to analyze and determine utility credit ratings.

Q. Please describe how these ratios are calculated and what they mean?

A. The first ratio, "Funds from operations/total debt (%)", calculates the amount of cash from operations as a percent of total debt. The ratio indicates the company's ability to fund debt obligations. The second ratio, "Funds from operations/interest coverage (x)", calculates the amount of cash from operations that is available to cover interest requirements. This ratio indicates how well a company's earnings can cover interest payments on its debt. The third ratio, "Total debt/total capital (%)", is the amount of debt in our total capital structure. The ratio is an indication of the extent to which the company is using debt to finance its operations. S&P looks at many other financial ratios; however, these are the three most important ratios they use when analyzing our financial profile.

Q. Do rating agencies make adjustments to the financial ratios that are calculated directly from the financial statements of the Company?

A. Yes. Rating agencies make adjustments to debt to factor in off-balance sheet commitments (for example, the accounts receivable program, purchased power agreements and the unfunded status of pension and other post-retirement benefits) that negatively impact the ratios. S&P has historically made adjustments to Avista's debt totaling approximately $226 million related to the accounts receivable program, purchased power and post-retirement benefits. The adjusted financial ratios for Avista are included in Illustration No. 3 above.

Q. Where does Avista fall within those coverage ratios?

A. Avista's cash flow ratios have improved as a result of the refinancing of the high cost debt that matured in June 2008. S&P and Moody's took this into account when they upgraded Avista in December 2007 and February 2008. Progress in increasing the cash flow ratios in recent years has been slower than anticipated due to below normal stream flows affecting hydro generation, higher thermal fuel costs than the amount included in rates and the resulting inability to eliminate electric deferral balances, and higher capital expenditures that require cash up front before we can recover the costs from customers. Each has an impact on the Company by reducing the amount of available cash flow from operations, requiring external financing and ultimately resulting in higher debt and lower cash flow ratios. In fact, S&P stated the following in a January 2008 research report on Pacific Northwest Hydrology:

> We find that Avista and Idaho Power, which are comparably sized companies, face the most substantial risk (related to hydro power) despite their PCAs and cost update mechanisms.[1]

Additionally, S&P stated the following in its February 2008 research update of Avista Corporation:

> The Company's financial performance will continue to be significantly affected by hydro conditions and gas prices. And the Company's key utility risk going forward is its exposure to high-cost replacement power, particularly in low water years.[2]

In order to improve the cash flow ratios, Avista must reduce its total debt balances and increase its available funds from operations. Although the Company has continued to work towards paying down its total debt, the negative impacts to cash flow caused by below-normal hydroelectric generation and volatility of wholesale electric market prices and natural gas prices in recent years, has adversely affected Avista's progress in improving the cash flow ratios.

Q. Do the rating agencies look at any other factors when evaluating a company's credit quality?

A. Yes. In addition to financial ratios and metrics, rating agencies also look at a number of qualitative factors which directly or indirectly may affect a company's cash flow. These factors include:

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[1] Standard and Poor's, *Pacific Northwest Hydrology and Its Impact on Investor-Owned Utilities' Credit Quality* , January 2008

[2] Standard and Poor's, *Avista Corp's Corporate Credit Rating Raised One Notch to BBB-*, February 2008

- Regulation
- Markets
- Operations
- Competitiveness, and
- Management

In evaluating these factors, the rating agencies look for regulatory actions that are supportive of cost recovery and that eliminate or minimize volatility of cash flows. They also consider the strength and growth of the economy in our service territory, operations' ability to control costs, whether our service is competitive, and the effectiveness of management.

Therefore, while the ratios are utilized in their quantitative evaluation of a company, they are not the only factors that are taken into account.

Q. What risks are Avista and the utility sector facing that may impact credit ratings?

A. Avista's credit ratings are impacted by risks that could negatively affect the company's cash flows. These risks include, but are not limited to, the level and volatility of wholesale electric market prices and natural gas prices for fuel costs, liquidity in the wholesale market (fewer counterparties and tighter credit restrictions), recoverability of natural gas and power costs, stream flow and weather conditions, changes in legislative and governmental regulations, relicensing hydro projects, rising construction and raw material costs, customers' ability to timely pay their bills, and access to capital markets at a reasonable cost.

Credit ratings for the utility sector are also adversely impacted by large capital expenditures for environmental compliance, and the need for new generation and transmission and distribution facilities. The utility sector is in a cycle of significant capital spending, which will likely be funded by large issuances of debt and equity. This increases the competition for financial capital at a time when the average utility credit rating is just above investment grade.

Given the downturn in the economy and the tightened credit markets, the rating agencies are keeping closer tabs on all companies in order to make sure there is sufficient liquidity in case the credit markets are inaccessible. Not having sufficient sources of cash for potential cash requirements could prompt a credit rating downgrade.

The increased capital spending needs and resulting increased debt issuances make regulation supporting the full and timely recovery of prudently incurred costs even more critical to the utility sector than in previous years.

Q. How important is the regulatory environment in which a Company operates?

A. The regulatory environment in which a company operates is a major qualitative factor in determining a company's creditworthiness. Moody's stated the following regarding Avista's regulatory environment in a December 2008 credit ratings report:

> "Avista benefits from credit supportive ratemaking practices in all three of its jurisdictions, which include periodic mechanisms to account for variations in the power and natural gas costs incurred as compared to the levels included in rates." However, Moody's also pointed out that "Failure to obtain adequate and timely support for recovery of and return on core utility investments through pending and expected future regulatory proceedings, or any unexpected material deviation from the back-to-basics strategy, are among the more important factors that could have negative rating implications."[3]

Additionally, in a January 2008 article published by S&P entitled "Top Ten US Electric Utility Credit Issues for 2008 and Beyond", S&P stated that "Recovering in a timely manner federally and/or state mandated compliance costs is paramount to preserving credit quality for regulated electric utilities."[4]

Due to the major capital expenditures planned by Avista, the continued supportive regulatory environment will be critical to Avista's financial health. Additionally, although Avista has electric and natural gas tracking mechanisms (PCA and PGA) to provide recovery of

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[3] Moody's Investor Service, *Moody's Upgrades Avista Corp* (December 3, 2008)

[4] Standard and Poor's, *Top Ten US Electric Utility Credit Issues for 2008 and Beyond*, January 2008

the majority of the variability in commodity costs, these changes in costs must be financed until the costs are recovered from customers. Investors and rating agencies are concerned about regulatory lag and cost-recovery related to these items.

Q. How do you expect the rating agencies will view the Company's proposed change in the PCA mechanism from a "90%/10%" to a "95%/5%" sharing?

A. I believe the rating agencies will view the Company's proposal favorably. In a report issued by S&P on January 14, 2009 relating to the approval by the IPUC on a similar change in Idaho Power's PCA, they stated "S&P said today that improvements to Idaho Power Company's annual PCA mechanism supports credit quality but will have no immediate impact on credit ratings." The changes are expected to reduce the under-collection of power costs and reduce cashflow volatility.

IV. CASH FLOW

Q. What are the Company's sources to fund capital requirements?

A. The Company utilizes cash flow from operations, long-term debt and common stock issuances to fund its capital expenditures. Additionally, on an interim basis, the Company utilizes its credit facilities to fund working capital needs and capital expenditures until longer-term financing can be obtained.

Q. What are the Company's near-term capital requirements?

A. As a combination electric and natural gas utility, over the next few years, capital will be required for customer growth, investment in generation, transmission and distribution facilities for the electric utility business, as well as necessary maintenance and replacements of our natural gas systems.

The amount of capital expenditures planned for 2009-2010 is approximately $420 million. For 2009 alone, these costs equate to a total of $210 million. Total ratebase at November 30, 2008 was $1.9 billion for the total Company; therefore, these planned capital additions represent substantial new investments given the relative size of the Company. A few of the major capital expenditure items on a system basis for 2009 include $60 million for electric transmission and distribution upgrades, $20 million for natural gas system upgrades, $10 million for environmental (associated with the Spokane River relicensing and the 2001 Clark Fork River license implementation issues),and $30 million for generation upgrades.

Q. What are the Company's long-term capital requirements?

A. Avista's Integrated Resource Plan has identified the potential need for the Company to finance significant expenditures for electric facilities. The preferred strategy outlined in our 2007 Integrated Resource Plan included total expenditures of $1.25 billion by 2018, including investment in wind resources and upgrades at hydroelectric stations.

Major capital expenditures are a normal part of utility operations. Customers are added to the service area, roads are relocated and require existing facilities to be moved, and facilities continue to wear out and need replacement. These and other requirements create the need for significant capital expenditures each year. We saw significant increases in the costs of raw materials over the past year, which our suppliers are continuing to pass through to us in the pricing of their finished products. Access to capital at reasonable rates is dependent upon the Company maintaining a strong capital structure, sufficient interest coverage, and investment grade credit ratings.

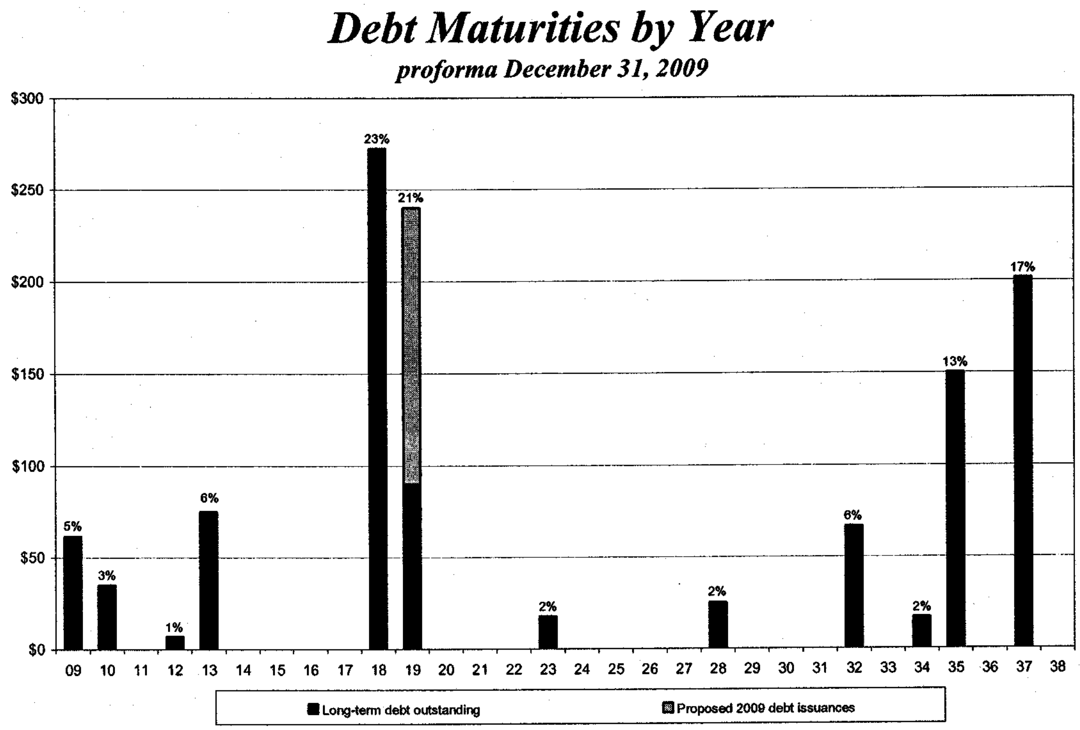
Q. What are the Company's near-term plans related to its debt?

A. During 2008 the Company issued $250 million of secured debt in April but, as explained earlier, chose not to go forward with a planned issuance of $100 million in long-term debt in September due to unfavorable conditions in the debt capital markets. The Company instead sought out and was able to establish a second bank line of credit in the amount of $200 million for 364 days to ensure continued adequate liquidity. The Company was also offered and accepted a private placement of $30 million of First Mortgage Bond secured 5-year debt.

The Company currently plans to issue up to $150 million of secured, fixed rate bonds during 2009. The proceeds from the issuance of the securities will be utilized to fund capital expenditures and repay funds borrowed under our credit facilities. The Company has no long-term debt scheduled to mature in 2009; however, it has an option to redeem $61.9 million of Trust Preferred Securities in March 2009.

Illustration No. 5 below shows the amount of debt maturities for Avista each year:

<u>Illustration No. 5:</u>



Q. Has the Company taken any steps to address the uncertainty related to interest rate exposure for the planned debt issuance in 2009?

A. Yes. The Company recently entered into four forward-starting interest rate swaps for a total of $100 million as a hedge on a portion of the interest payments on the long-term debt we are planning to issue in 2009. The Company is continuing to analyze the possibility of entering into additional transactions in order to lock in the interest rate on a greater portion of the debt at a time when Treasury rates are at all-time historical lows.

Q. What is the status of the Company's lines of credit secured by first mortgage bonds and its accounts receivable program?

A. The Company has a $320 million line of credit that expires in April 2011, and a $200 million line of credit that expires November 24, 2009. The Company has the option of increasing the $320 million line by $100 million (up to $420 million) at any time during the term of the agreement, subject to additional fees and obtaining bank commitments. The agreement includes the option to release the first mortgage bond security when the Company has an investment grade credit rating. The Company also has the option of renewing or upsizing the $200 million deal to $250 million under certain circumstances. Additionally, the Company has an $85 million accounts receivable funding program that expires in March 2009. This agreement has been renewed on a year-to-year basis, and we expect to extend the agreement for another year.

The facilities have been sized to allow the Company to maintain a liquidity cushion of at least $125 million at all times to cover required working capital, counterparty collateral requirements, and avoid issuing debt in unfavorable market conditions if they persist through 2009. Our liquidity is strong and we are confident that our current agreements give us flexibility while facing both the volatile financial markets and volatile energy commodity prices.

Many purchases of natural gas, or contracts for pipeline capacity to provide natural gas transportation, require collateral, and/or prepayments, based upon the Company's credit rating. Upgrades to Avista's credit ratings during 2007 and 2008 have reduced the amount of collateral required to be posted with counterparties. If Avista is upgraded above its current credit ratings, the Company should see an increase in the number of counterparties willing to do business with us and the collateral requirements are expected to decrease even further, resulting in reduced borrowing costs. The lines of credit and accounts receivable program are our primary sources of immediate cash for borrowing to meet these needs and for supporting the use of letters of credit. A line of credit is required to manage daily cash flow since the timing of cash receipts versus cash disbursements is never totally balanced.

Q. What are Avista's plans regarding common equity and why is this important?

A. Avista will continue to monitor the common equity ratio of its capital structure, and assess the need to issue additional common equity. Avista entered into a sales agency agreement in December 2006 to issue up to two million shares of our common stock from time to time.

During the third quarter of 2008, we issued 750,000 shares of common stock under this agreement. Our plan for 2009 is to continue with the periodic offering of common stock as needed to support the Company's common stock ratio. To the extent that we are not able to access the equity market, there will be increased pressure on our lines of credit, and an increased need to issue long term debt, which is likely to unfavorably impact our cost of debt and debt to equity ratio. It is important to the rating agencies for Avista to maintain a balanced debt/equity ratio in order to minimize the risk of default on required debt interest payments.

As Dr. Avera explains in his testimony, the 50.0 percent common equity ratio requested by Avista in this case is consistent with the range of equity ratios maintained by the firms in the Utility Proxy Group.

Dr. Avera notes that electric utilities are facing, among other things, rising cost structures, the need to finance significant capital investment plans, and uncertainties over accommodating future environmental mandates. A more conservative financial profile, in the form of a higher common equity ratio, is consistent with increasing uncertainties and the need to maintain the continuous access to capital that is required to fund operations and necessary system investment, even during times of adverse capital market conditions.

He also discusses Moody's warning to investors of the risks associated with debt leverage and fixed obligations and their advice to utilities to not squander the opportunity to strengthen the balance sheet as a buffer against future uncertainties. Moody's noted that, absent a thicker equity layer, utilities would be faced with lower credit ratings in the face of rising business and operating risks:

> There are significant negative trends developing over the longer-term horizon. This developing negative concern primarily relates to our view that the sector's overall business and operating risks are rising - at an increasingly fast pace - but that the overall financial profile remains relatively steady. A rising risk profile accompanied by a relatively stable balance sheet profile would ultimately result in credit quality deterioration.[5]

This is especially the case for Avista, which faces the dual challenge of financing significant capital expansion plans in a turbulent market while at the same time endeavoring to improve its credit standing. Avista is committed to maintaining an appropriate level of equity to support a strong credit rating.

Q. What are Avista's plans regarding preferred equity and other financing structures (for example, hybrid instruments)?

A. Avista does not have any preferred equity or other financing structures outstanding at December 31,

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[5] Moody's Investors Service, "U.S. Electric Utility Sector," *Industry Outlook* (Jan. 2008).

2008. Currently, Avista does not plan to issue preferred equity or other financing structures, but will continue to evaluate the appropriateness of these financing vehicles.

V. CAPITAL STRUCTURE

Q. Please explain the capital structure proposed by Avista in this case.

A. Avista's current capital structure consists of a blend of long-term debt and common equity necessary to support the assets and operating capital of the Company. The proportionate shares of Avista Corp.'s actual capital structure on September 30, 2008, are shown on page 1 of Exhibit No. 2, Schedule 2. A pro forma capital structure is also shown on page 1 in the Schedule, which reflects expected changes for the period ending June 30, 2009. Supporting workpapers provide additional details related to these adjustments on pages 3 through 4.

The rate of return to be applied to rate base in this proceeding is equal to the weighted average cost of capital, taking into account the pro forma adjusting items. As shown on page 1 of Exhibit No. 2, Schedule 2, Avista Utilities is proposing an overall rate of return of 8.80%.

VI. COST OF DEBT

Q. How have you determined the cost of debt?

A. Cost of debt in the Company's proposed capital structure includes long-term debt. As shown on page 1 of Schedule 2 of Exhibit No. 2, the actual weighted average cost of long-term debt outstanding on September 30, 2008 was 6.91%. The size and mix of debt changes over time based upon the actual financing completed. We have made certain pro forma adjustments to update the debt cost through June 30, 2009 to 6.60%. Pro forma adjustments to long-term debt reflect expected maturities of outstanding debt and the issuance of new debt to fund those maturities. The pro forma weighted cost of long-term debt was reduced from 3.45% to 3.30%.

VII. COST OF COMMON EQUITY

Q. What rate of return on common equity is the Company proposing in this proceeding?

A. As further explained by Dr. Avera, the cost of equity has increased since the conclusion of Avista's last general rate case. Difficult economic conditions and increased volatility in the financial markets have caused a flight to quality among investors, meaning that they have a preference for investments with very low risk, such as U.S. Treasury bonds, and they are demanding a higher premium (return) for taking additional risk. As explained earlier in my testimony, the interest rate spreads between US Treasuries and utility bonds increased dramatically in the later part of 2008. Equity investments inherently contain more risk, and our cost of equity has also increased since our last rate case.

The Company is proposing an 11.0% return on common equity (ROE), which falls below the lower end of Dr. Avera's recommended range of required return on equity. Dr. Avera testifies to analyses related to the cost of common equity with an ROE range of 11.3% to 13.3%. In his testimony Dr. Avera states that:

> Considering investors' expectations for capital markets and the need to support financial integrity and fund crucial capital investment even under adverse circumstances, I concluded that Avista's requested ROE of 11.0% percent is reasonable. (P. 5, L. 40 - P. 6, L. 1)

Q. Dr. Avera suggests an ROE range of 11.3% to 13.3%. Why is Avista requesting an ROE below the lower end of the range?

A. As I have testified, Avista has made solid progress towards improving its financial health. If Avista can earn an 11.0% ROE, I believe our financial condition would continue to improve and would further strengthen the credit ratings ratios.

Furthermore, as the Company has worked toward improving its financial condition over the last several years, it has done so with the customer in mind. Avista is attempting to balance the ability to continue to improve our financial health and access capital markets under reasonable terms with the impacts that increased retail rates have on its customers. In this case, although we believe an ROE greater than 11.0% is supported and is warranted, we also believe the 11.0% provides a reasonable balance of the competing objectives.

Q. Please summarize the proposed capital structure and the cost components for debt and common equity.

A. As also shown on page 1 of Exhibit No.2, Schedule 2, the following illustration shows the capital structure and cost components proposed by the Company.

Illustration No. 6:

AVISTA CORPORATION Capital Structure and Overall Rate of Return					
PRO FORMA Cost of Capital as of June 30, 2009	Amount		Percent of Total Capital	Cost	Component
Total Debt	$945,800,000	*	50.00%	6.60%	3.30%
Common Equity	1,061,732,371	*	50.00%	**11.00%**	5.50%
TOTAL	$2,007,532,371		100.00%		**8.80%**

* Pro forma Common Equity of 50% is less than calculated Common Equity based on Pro Forma Capital Structure at June 30, 2009 calculated above

VIII. INCREASE IN PENSION EXPENSE

Q. Has the Company included an adjustment in this filing for increased pension expense?

A. Yes. The Company's pension expense has increased, on a system basis, from $12.1 million for the test year ended September 30, 2008 to $18.4 million[6] for 2009. Company witness Ms. Andrews discusses the accounting adjustment to results of operations to reflect this.

Q. What is the reason for the increase in pension expense in 2009?

A. The increase in pension expense is due primarily to the negative overall market performance in 2008.

[6] Most recent analysis, just prior to this filing, indicates that the pension cost for 2009 may be higher at $22.2 million.

Although the pension plan assets are diversified among investment classes, negative returns were associated with virtually all assets except cash. The stock market had a negative 38% return on the S&P 500 Index, and bond markets and commodities also performed negatively in 2008.

The Company's 2008 pension plan return on assets is estimated to be negative 21%. The negative returns and resulting declining value of our pension plan assets increased the pension expense for 2009.

The overall market decline impacted the pension plan assets of other companies as well. Most companies with defined benefit pension plans have experienced similar asset value declines and increased funding levels as a result of general market conditions and the Pension Protection Act of 2006 (PPA).

Results from an EEI survey conducted in early December 2008, indicated that all 24 electric utilities who participated in the survey were estimating negative returns for their pension plan assets in 2008. The 2008 average expected pension returns of the 24 companies surveyed was a negative 26.7%. The Company's pension returns, as described above, were somewhat better than these reported returns.

Q. Will you describe the process utilized by the Company for administering investments in its defined benefit plan (pension plan)?

A. Yes. The Company has a very disciplined approach to the oversight and monitoring of the pension plan. The Board of Directors of the Company, acting through the Finance Committee of the Board, is responsible for setting, monitoring and adjusting the Investment Policy Statement (IPS) with respect to the investment of funds for the pension plan. The IPS summarizes the Finance Committee's investment policies for the management and oversight of the pension plan. It sets forth the objectives of the plan, the strategies designed to achieve these objectives, procedures for monitoring and control of plan assets and the delegation of responsibilities for the oversight and management of plan assets. Given the long-term time horizon of the pension plan, the IPS is designed to endure multiple market environments and to not be reactive to what might be considered normal short-term events. The IPS includes a policy portfolio that envisions a reasonably stable allocation of assets among major asset classes.

Q. What are the investment policies for management and oversight of the pension plan?

A. As stated in the IPS, the objectives of the pension plan are designed to provide a total return that, over the long term, provides sufficient assets to fund its liabilities subject to an acceptable level of risk, contributions and pension expense deemed appropriate by the Board Finance Committee and to diversify investments within asset classes to reduce the impact of losses in single investments.

Q. What resources does the Company utilize to perform its duties under the Investment Policy Statement related to investment of Pension Assets?

A. The Company retains an external investment management consultant to develop and recommend asset allocation of the pension plan assets, evaluate and recommend investment managers and monitor the performance and business of the investment managers of the plan assets. This consultant provides a quarterly performance and compliance report of the plan assets. The performance report is reviewed by the Company's internal Benefits Plan Administration Committee quarterly. The performance report is also reviewed by the Board Finance Committee on a quarterly basis. In addition, a report detailing compliance with the specific requirements of the IPS is provided quarterly to the Board Finance Committee.

Q. What are the impacts of the Pension Protection Act (PPA) on the Company's Pension plan?

A. The PPA was passed in 2006 and requires annual increases to the pension funding level in order to eventually achieve a fully funded plan. The PPA established that in 2008 the funding level would be 92% of the pension plan obligations. For 2009 this level increases to 94%. In 2008, Avista's funding level was 92%

and is projected to be 94% in 2009, based on increased Company contributions to the plan. If the plan funding level does not meet these established percentages, the entire funding deficit must be added to the contribution over the next seven years in order to be fully funded after seven years. If the percentage falls below 80%, plan restrictions would be imposed and the plan would be considered "at-risk." Should this occur, benefit accruals would be frozen and plan participants would not be able to accrue additional pension benefits. Additionally, lump sum distributions to participants would not be allowed.

To avoid these restrictions the Company is committed to fully meeting these funding levels and complying with the requirements of the PPA.

Q. Do the annual cash contributions to the pension fund equal the annual pension expense recognized by the Company?

A. No. In fact the cash contribution that Avista will make to the pension fund in 2009 will be substantially higher than the proforma expense of $18.4 million identified earlier. The annual cash contribution is driven by the need to comply with the funding requirements of the PPA (e.g., 94% funded by the end of 2009). It will be necessary to make a cash contribution to the pension fund in 2009 of at least $42 million, and more recent analysis indicates that we may need to contribute $67 million of cash in 2009.

The pension expense recognized by the Company is determined using a formula as prescribed by Financial Accounting Standard No. 87 (FAS 87). The objective of FAS 87 is to recognize the compensation cost of an employee's pension benefits (including prior service cost) over that employee's approximate service period. While the pension cash contribution amount does affect the pension expense, the FAS 87 assumptions and calculations are different from those used to determine the funded status.

As can be seen by the differences in the 2009 cash contribution of $67 million and the pension expense of $18.4 million, the differing requirements of the PPA and FAS 87 can result in a substantial difference between cash contributions and recognition of expense. The current level of pension expense reflected for ratemaking purposes is $11.85 million. Therefore, until the conclusion of this case, the current annualized difference between the cash contribution and pension expense is over $55 million ($67 million - $11.85 million).

Q. What impact does that timing difference have on the Company?

A. The result for Avista in 2009 is that the Company would make a cash payment of $67 million, while recovering $11.85 million of expense through its retail rates. Absent some form of accounting treatment or other relief from the Commission, Avista would not recover the time value of money on the difference between the cash payment and the level of expense. Because of the magnitude of this difference, the absence of a carrying cost would have a significant impact on the earnings of the Company. The difference of $55 million times the requested rate of return of 8.80% is $4.8 million for 2009 alone.

Q. Have you seen these kinds of cash versus expense differences in the past?

A. Nothing even close to this magnitude. A comparison of cash payments versus pension expense for each year from 1992 through 2008 is shown in Illustration No. 7 below. Not only are the annual differences much smaller, but on a cumulative basis through 2007, the difference is only $1.4 million. However, in 2008 the cash payment is $16.0 million higher than the expense, and the difference for 2009 will be even greater.

Illustration No. 7:

Year	Cash Contribution	Annual Expense	Difference	Cumulative Difference
1992	$0.0	-$1.1	$1.1	$1.1
1993	$0.0	-$0.5	$0.5	$1.6
1994	$0.0	$1.0	-$1.0	$0.6
1995	$0.0	$2.0	-$2.0	-$1.4
1996	$0.0	$2.4	-$2.4	-$3.8
1997	$3.3	$2.2	$1.1	-$2.7
1998	$0.0	$1.5	-$1.5	-$4.2
1999	$0.0	$2.4	-$2.4	-$6.6
2000	$3.3	$0.8	$2.5	-$4.1
2001	$0.0	$3.8	-$3.8	-$7.9
2002	$12.0	$9.3	$2.7	-$5.2
2003	$12.0	$14.9	-$2.9	-$8.1
2004	$15.0	$13.6	$1.4	-$6.7
2005	$15.0	$11.9	$3.1	-$3.5
2006	$15.0	$12.8	$2.2	-$1.3
2007	$15.0	$12.3	$2.7	$1.4
2008	$28.0	$12.0	$16.0	$17.3

Q. Do you expect these major cash versus expense differences to continue for the indefinite future?

A. No. Although they may continue for some period of time, as the financial markets recover, which we anticipate they will at some point, the cash contribution requirement for the pension plan will come down and potentially go to zero at some point. At that point, there would be opportunity for the cumulative difference between cash and expense to again move toward zero.

In the meantime, however, we have a significant difference between the cash contribution and pension expense that needs to be addressed in some way.

Q. What is the Company proposing with regard to this difference between the cash contribution to fund the pension plan and the annual level of pension expense?

A. Due to the substantial difference between the 2009 pension payment and the amount of authorized utility pension cost, the Company is requesting approval to establish a regulatory asset for the <u>carrying costs</u> on the cumulative difference between payments and authorized pension cost. It is important to emphasize that we are not requesting accounting treatment to defer the actual dollar differences between the cash payment and expense, but only the <u>carrying cost</u> on those dollar differences.

In future periods if the pension cash payments are less than the authorized cost, the cumulative difference will decrease and the resulting carrying cost accrual will decrease.

Q. When does the Company propose to start the accrual of the carrying cost, and at what rate?

A. The Company is proposing to begin accruing the carrying charge effective February 1, 2009, at its authorized rate of return during the month the accrual occurs, compounded annually. The current authorized rate of return is 8.45%.

Q. How would the accrual calculations be made?

A. A reduction to the cash payments would first be made to remove the portion related to non-utility. The remaining utility portion would be allocated to utility jurisdictions and services based on the labor dollars included in this filing.

Assuming the Company will be making contributions to the pension plan in 2009 of $67 million, after removing the portion of pension costs related to non-utility companies of 0.42%, or $0.28 million, the remaining portion of the $67 million related to utility operations amounts to $66.72 million. In contrast, the amount of pension expense related to utility operations on a system basis is $11.85 million from the last general rate case.

A carrying charge would be accrued each month, beginning February 1, 2009, based on the cumulative difference between the actual cash payments and the authorized pension expense.

Q. What accounts would be used to account for the accrual of the carrying cost?

A. The accrual of the carrying cost would be recorded by debiting Account 182.3 - Other Regulatory Assets and crediting Account 419 - Interest Income. The carrying cost calculation and a breakdown of the regulatory asset would be maintained by utility jurisdiction (Washington and Idaho) and utility service (electric and gas). Should the accrual become negative, Account 431 - Other Interest Expense would be debited and Account 182.3 would be credited until the balance in Account 182.3

reaches zero, and then, Account 254 - Other Regulatory Liabilities would be credited. Deferred federal income taxes would be recorded by debiting Account 410.2 - Provision for Deferred Income Taxes, Other Income and Deductions and crediting Account 283 - Accumulated Deferred Income Taxes-Other.

Q. How would the deferred carrying costs be recovered in rates?

A. The Company would continue to review the balance of deferred carrying costs to determine if a rate adjustment to recover the costs was necessary. The regulatory asset/regulatory liability accounts will function like a balancing account. While a regulatory asset will be created in 2009, a rebound in the investment market could cause the regulatory asset to be offset by regulatory liability entries over a period of time, and no rate adjustment would be necessary. If a rate adjustment were to become necessary, the Company would file a request as part of a general rate case or other filing to recover the deferral balance.

Q. Does that conclude your pre-filed direct testimony?

A. Yes.

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UTILITIES COMMISSION

DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL OF
REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-8851

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	CASE NO. AVU-E-09-01 CASE NO. AVU-G-09-01 EXHIBIT NO. 2 MARK T. THIES

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

AVISTA CORPORATION
Long-term Securities Credit Ratings

	Standard & Poor's		Moody's		Fitch	
Last Reviewed	February 2008		December 2007		August 2007	
Credit Outlook	Stable		Stable		Positive	
	A+		**A1**		**A+**	
	A		**A2**		**A**	
	A-		**A3**		**A-**	
	BBB+	First Mortgage Bonds Secured Medium-Term Notes	**Baa1**		**BBB+**	
	BBB		**Baa2**	First Mortgage Bonds Secured Medium-Term Notes	**BBB**	First Mortgage Bonds Secured Medium-Term Notes
	BBB-	Avista Corp./Corporate rating Senior Corporate Notes 9.75%	**Baa3**	Avista Corp./Issuer rating Senior Corporate Notes 9.75%	**BBB-**	Senior Corporate Notes 9.75%
	INVESTMENT GRADE					
	BB+		**Ba1**	Trust-Originated Preferred Securities	**BB+**	Avista Corp./Issuer rating Trust-Originated Preferred Securities
	BB	Trust-Originated Preferred Securities	**Ba2**		**BB**	
	BB-		**Ba3**		**BB-**	

AVISTA CORPORATION
Capital Structure and Overall Rate of Return

PRO FORMA Cost of Capital as of June 30, 2009	Amount		Percent of Total Capital	Cost	Component
Total Debt	$945,800,000	*	50.00%	6.60%	3.30%
Common Equity	1,061,732,371	*	50.00%	**11.00%**	5.50%
TOTAL	$2,007,532,371		100.00%		**8.80%**

EMBEDDED Cost of Capital as of September 30, 2008	Amount	Percent of Total Capital	Cost	Component
Total Debt	$1,000,800,000	49.91%	6.91%	3.45%
Common Equity	1,004,427,887	50.09%	**10.20%**	5.11%
TOTAL	$2,005,227,887	100.00%		**8.56%**

* Pro forma Common Equity of 50% is less than calculated Common Equity based on Pro Forma Capital Structure at June 30, 2009 calculated above

Assumptions
1. Started with 9-30-2008 actual
2. Proforma through 6-30-2009
3. The forecasted equity and debt numbers come from forecast SEP18 model run
4. Equity is adjusted for Other Comprehensive Income and capital stock expense of $25,853,741
5. Forecasted issuance of $14.75 million of additional equity through different company programs

AVISTA CORPORATION
Cost of Long-Term Debt Detail
June 30, 2009

Line No.	Description	Coupon Rate	Maturity Date	Settlement Date	Principal Amount	Issuance Costs	Redemption Costs	Net Proceeds	Yield to Maturity	Principal Outstanding 06-30-2009	Effective Cost	Line No.
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	
1	SMTN Series A	Series Costs A	08-31-2010	05-01-1993		373,693					21,663	1
2	SMTN Series A	6.67%	07-12-2010	07-12-1993	5,000,000	35,081	690,464	4,274,455	8.275%	5,000,000	413,765	2
3	SMTN Series A	7.18%	08-11-2023	08-12-1993	7,000,000	54,364		6,945,636	7.244%	7,000,000	507,064	3
4	SMTN Series A	7.37%	05-10-2012	05-10-1993	7,000,000	49,114	1,227,883	5,723,003	9.455%	7,000,000	661,877	4
5	SMTN Series A	7.39%	05-11-2018	05-11-1993	7,000,000	54,364	1,227,883	5,717,753	9.287%	7,000,000	650,114	5
6	SMTN Series A	7.45%	06-11-2018	06-09-1993	15,500,000	170,597	2,140,440	13,188,963	8.953%	15,500,000	1,387,715	6
7	SMTN Series A	7.53%	05-05-2023	05-06-1993	5,500,000	42,712	963,011	4,494,277	9.359%	5,500,000	514,744	7
8	SMTN Series A	7.54%	05-05-2023	05-07-1993	1,000,000	7,766	175,412	816,822	9.375%	1,000,000	93,747	8
9	SMTN Series B	6.90%	07-01-2010	06-09-1995	5,000,000	37,944		4,962,056	6.982%	5,000,000	349,077	9
10	5.70% FMB's	5.70%	07-01-2037	12-15-2006	150,000,000	8,662,304		141,337,696	6.120%	150,000,000	9,179,674	10
11	6.125% FMB's	6.13%	09-01-2013	09-08-2003	45,000,000	1,055,140	815,824	43,129,036	6.703%	45,000,000	3,016,248	11
12	5.45% FMB's	5.45%	12-01-2019	11-18-2004	90,000,000	1,432,081		88,567,919	5.608%	90,000,000	5,047,001	12
13	6.25% FMB's	6.25%	12-01-2035	11-17-2005	150,000,000	-2,192,918		152,192,918	6.143%	150,000,000	9,213,798	13
14	5.95% FMB's	5.95%	06-01-2018	04-02-2008	250,000,000	19,475,000		230,525,000	7.034%	250,000,000	17,585,144	14
15	7.25% FMB's	7.25%	12-16-2013	12-16-2008	30,000,000	400,000		29,600,000	7.575%	30,000,000	2,272,593	15
16	PCB's Kettle Falls	6.00%	12-01-2023	07-29-1993	4,100,000	135,855	146,393	3,817,752	6.523%	4,100,000	267,441	16
17	[4] PCB's Series 1999A	6.75%	10-01-2032	03-31-2009	66,700,000	1,334,000	7,466,134	57,899,866	8.004%	66,700,000	5,338,954	17
18	MTN's Series C	Series Costs C	06-15-2013	06-15-1998		650,179					43,345	18
19	MTN's Series C	6.37%	06-19-2028	06-19-1998	25,000,000	158,304	188,649	24,653,047	6.475%	25,000,000	1,618,863	19
20	MTN's Series C	8.02%	10-26-2010	10-26-1999	25,000,000	161,287	707,527	24,131,186	8.513%	25,000,000	2,128,207	20
21								841,977,385	6.786%	888,800,000	60,311,037	21
22												22
23	Repurchase [1]	7.74%	12-31-2017	06-30-2006	6,875,000		483,582	6,391,418	8.721%	[2]	66,586	23
24	Repurchase [1]	8.17%	06-30-2015	06-30-2005	26,000,000		1,735,796	24,264,204	9.206%	[2]	257,559	24
25	Repurchase [1]	8.41%	06-30-2014	06-30-2004	36,590,000		7,358,680	29,231,320	11.903%	[2]	1,297,205	25
26	Repurchase [1]	8.68%	09-30-2012	06-30-2003	52,485,000		2,819,860	49,665,140	9.564%	[2]	481,179	26
27	Repurchase [1]	8.76%	09-30-2010	06-30-2002	203,590,000		9,958,782	193,631,218	9.628%	[2]	1,841,480	27
28											3,944,009	28
29												29
30		[3] Var. Rate Long-Term Debt			40,000,000	1,296,086	-2,500,000	41,203,914	3.172%	40,000,000	1,268,930	30
31	[4]	[3] Var. Rate Long-Term Debt			17,000,000	340,000	2,332,632	14,327,368	4.766%	17,000,000	810,268	31
32												32
33				TOTAL PRO FORMA COST OF DEBT 6/30/2009				897,508,667	**6.597%**	945,800,000	62,390,235	33

1 The coupon rate used is the cost of debt at the time of the repurchases
2 The amounts are calculated using the IRR function
3 Information pulls from the - Var. Rate Long-Term tab
4 Forecasted issuances

Exhibit No. 2
Case No. AVU-E-09-01 AVU-G-09-01
M. Thies, Avista
Schedule 2, p. 2 of 3

AVISTA CORPORATION
Proforma Cost of Long-Term Variable Rate
June 30, 2009

Line		Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Avg of
2	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)
3	Trust Preferred	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	**40,000,000**
4	PBC's	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	$17,000,000	**17,000,000**
5	Total Short Term Debt	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	$57,000,000	**$57,000,000**
6															
7	Number of Days in Month		31	31	30	31	30	31	31	28	31	30	31	30	365
8	Actual Rates Trust Preferred		3.56%	3.56%	3.69%	3.69%	3.69%	3.06%	3.06%	3.06%	3.13%	2.88%	2.88%	2.88%	
9	Trust Preferred Interest Expense		122,519	122,519	122,833	126,928	122,833	105,273	105,273	95,085	107,811	96,000	99,200	96,000	**1,322,273**
10	Total Interest Expense		122,519	122,519	122,833	126,928	122,833	105,273	105,273	95,085	107,811	96,000	99,200	96,000	1,322,273
11	Forecasted Monthly Borrowing Rate		3.56%	3.56%	3.69%	3.69%	3.69%	3.06%	3.06%	3.06%	3.13%	2.88%	2.88%	2.88%	
12										Average borrowing rate used in the caluclation of the effective costs below					3.31%
13															
14	Number of Days in Month		31	31	30	31	30	31	31	28	31	30	31	30	365
15	Actual Rates PCB's		5.13%	5.13%	5.13%	5.13%	5.13%	5.13%	2.25%	2.25%	2.25%	2.00%	2.00%	2.00%	
16	PBC's		75,024	75,024	72,604	75,024	72,604	75,024	32,938	29,750	32,938	28,333	29,278	28,333	**626,875**
17	Total Interest Expense		75,024	75,024	72,604	75,024	72,604	75,024	32,938	29,750	32,938	28,333	29,278	28,333	626,875
18	Forecasted Monthly Borrowing Rate		5.13%	5.13%	5.13%	5.13%	5.13%	5.13%	2.25%	2.25%	2.25%	2.00%	2.00%	2.00%	
19										Average borrowing rate used in the caluclation of the effective costs below					3.69%

20
21
22

Line	Description	Coupon Rate	Maturity Date	Settlement Date	Principal Amount	Issuance Costs	Loss/Reacq Expenses	Net Proceeds	Yield to Maturity	Principal Outstanding 12-31-2008	Effective Cost
26	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
27	Trust Preferred	3.31%	06-01-2037	06-03-1997	40,000,000	1,296,086	-2,500,000	41,203,914	3.172%	40,000,000	1,268,930
28	PCB's	3.69%	03-01-2034	12-31-2008	17,000,000	340,000	2,332,632	14,327,368	4.766%	17,000,000	810,268
29											