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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION	)	CASE NO. AVU-E-17-01
OF AVISTA CORPORATION FOR THE	)	CASE NO. AVU-G-17-01
AUTHORITY TO INCREASE ITS RATES	)	
AND CHARGES FOR ELECTRIC AND	)	
NATURAL GAS SERVICE TO ELECTRIC	)	DIRECT TESTIMONY
AND NATURAL GAS CUSTOMERS IN THE	)	OF
STATE OF IDAHO	)	MARK T. THIES
	)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

I. INTRODUCTION

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

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

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

A. I received a Bachelor of Arts degree in 1986 with majors 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.

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 Avista Corporation as well as explain the proposed capital structure, overall rate of return, and our credit ratings. Additionally, I will summarize our capital expenditures program. Mr. Adrien McKenzie, on behalf of Avista, will provide additional testimony related to the appropriate return on equity for Avista, based on our specific circumstances, together with the current state of the financial markets.

In brief, I will provide information that shows:

- Avista's plans call for a continuation of utility capital investments in generation, transmission and distribution systems to preserve and enhance service reliability for our customers. Capital expenditures of approximately $2 billion are planned for the five-year period ending December 31, 2021. Avista needs adequate cash flow from operations to fund these requirements and for repayment of maturing debt, together with access to capital from external sources under reasonable terms, on a sustainable basis.

- We are proposing an overall rate of return of 7.81 percent, which includes a 50.0 percent common equity ratio, a 9.9 percent return on equity, and a cost of debt of 5.72 percent. We believe our proposed overall rate of return of 7.81 percent and proposed capital structure provide a reasonable balance between safety and economy.

- Avista's corporate credit rating from Standard & Poor's is currently BBB and Baa1 from Moody's Investors Service. Avista must operate at a level that will support a solid investment grade corporate credit rating in order to access capital markets at reasonable rates. A supportive regulatory environment is an important consideration by the rating agencies when reviewing Avista. Maintaining solid credit metrics and credit ratings will also help support a stock price necessary to issue equity under reasonable terms to fund capital requirements.

A table of contents for my testimony is as follows:

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

A. Yes. I am sponsoring Exhibit No. 2, Schedules 1 through 4. Schedule 1, page 1, includes Avista's credit ratings by S&P and Moody's. Avista's actual capital structure at December 31, 2016, and proposed capital structure at January 1, 2018, are included on page 2, with supporting information on pages 3 through 5. Confidential Exhibit No. 2, Schedule 2C includes the Company's planned capital expenditures and long-term debt issuances by year. Confidential Exhibit No. 2, Schedule 3C includes our Interest Rate Risk Management Plan. Finally, Exhibit No. 2, Schedule 4 includes the weighted cost of equity requested by investor-owned utilities from May 1, 2016, through April 30, 2017.

II. FINANCIAL OVERVIEW

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

A. We are operating the business efficiently for our customers, ensuring that our energy service is reliable and customers are satisfied while at the same time keeping costs as low as reasonably possible. An efficient, well-run business is not only important to our customers but also important to investors. We plan and execute on a capital financing plan that provides a prudent capital structure and liquidity necessary for our operations. We honor prior financial commitments and we continue to rely on external capital for sustained utility operations. We initiate regulatory processes to seek timely recovery of our costs with the goal of achieving earned returns close to those allowed by regulators in each of the states we serve. These elements – cost management, capital and revenues that support operations – are key determinants to the rating agencies whose credit ratings are critical measures of our financial situation.

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

A. We are working to assure there are adequate funds for operations, capital expenditures and debt maturities. We obtain a portion of these funds through the issuance of long-term debt and common equity. We actively manage risks related to the issuance of long-term debt through our interest rate risk mitigation plan and we maintain a proper balance of debt and common equity through regular issuances and other transactions. We actively manage energy resource risks and other financial uncertainties inherent in supplying reliable energy services to our customers. We create financial plans and forecasts to model our income, expenses and investments, providing a basis for prudent financial planning. We seek timely recovery of our costs through general rate cases and other ratemaking mechanisms.

The Company currently has a sound financial profile. It is very important for Avista to maintain and enhance its financial position in order to access debt and equity financing as Avista funds significant future capital investments and refinances maturing debt.

A key component of a continued long-term sound financial profile is the ability to receive timely recovery of capital additions and expenses, so the Company can earn its authorized return. When regulatory mechanisms do not respond to changing cost factors, the level of return can move substantially below the authorized level. This creates financial weakness and concern in financial markets about the long-term stability of the Company.

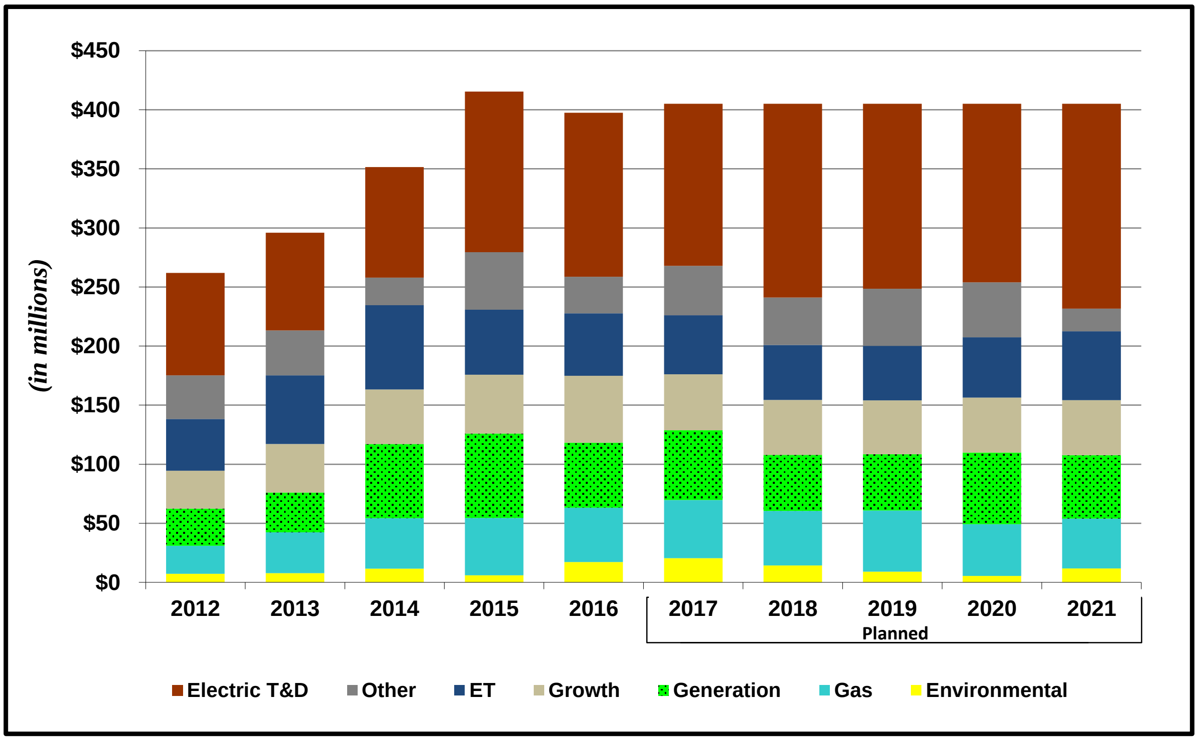
III. CAPITAL EXPENDITURES

Q. What is Avista's recent and planned capital expenditure levels?

A. Illustration No. 1 below summarizes the capital expenditure levels for recent years, as well as planned expenditures through 2021.

Illustration No. 1

Capital Expenditures



** The higher level of capital expenditure in 2015 was driven by storm costs for the November windstorm, and costs related to a renegotiation of the Coyote Springs Long Term Service Agreement, which occurred late in the year.*

The capital expenditure level is expected to remain constant at $405 million annually from 2017 through 2021.

Q. What is the basis for the Company's planned level of capital expenditures?

A. The level of capital investment in recent years has been driven primarily by the business need to fund a greater portion of the departmental requests for new capital investments that, in the past, were unfunded.

As Mr. Morris explains in his testimony, each year the departments across the Company assess the near-term needs to maintain and upgrade the utility infrastructure and technology necessary to continue to provide safe, reliable service to customers, as well as maintain a high level of customer satisfaction. The departments develop business cases for specific projects and programs that explain and support the need for the capital investment. These business cases are submitted to a Capital Planning Group that meets on a regular basis to review and prioritize all proposed utility capital investment projects.

After taking into consideration a number of factors, senior management of Avista establishes a proposed capital budget amount for each year of the next five years, which is presented to the Finance Committee of the Board of Directors[1].

Company witnesses Mr. Kinney, Ms. Rosentrater, and Mr. Kensok provide additional details on why the specific capital investments are needed in the time frame in which they are planned, and also address the risks and/or consequences of not completing the investments.

IV. MATURING DEBT

Q. How is Avista affected by maturing debt obligations from 2018 through 2022?

A. Beginning in 2018 through 2022 the Company is obligated to repay maturing long-term debt totaling $654.5 million. The table in Illustration No. 3 below shows the Company's maturing long-term debt from 2018 through 2022. Within this five-year period, a large concentration – $272.5 million – matures within the second quarter of 2018, and another $250 million within the second quarter of 2022.

[1] The Finance Committee is presented with a five-year plan, but approves the plan for only the next operating year.

Illustration No. 3

Avista Corp Long-Term Debt Maturities, 2018-2022				
Maturity Year	**Principal Amount**	**Coupon Rate**	**Date Issued**	**Maturity Date**
2018	$7,000,000 $250,000,000 $15,500,000	7.39 percent 5.95 percent 7.45 percent	5/11/1993 4/3/2008 6/9/1993	5/11/2018 6/1/2018 6/11/2018
2019	$90,000,000	5.45 percent	11/18/2004	12/2/2019
2020	$52,000,000	3.89 percent	12/20/2010	12/20/2020
2021	$0			
2022	$250,000,000	5.13 percent	9/22/2009	4/1/2022
Total	$654,500,000			

These debt obligations originated as early as 1993 and their original terms were three, ten, fifteen and twenty-five years. These maturing obligations represent over a third (39 percent) of the Company's long-term debt outstanding at the end of 2016, which is a significant portion of our capital structure. The Company typically replaces maturing long-term debt with new issuances of debt. It will be necessary for Avista to be in a favorable financial position to complete the expected debt refunding, while also obtaining debt and equity to fund capital expenditures each year and maintain an adequate capital structure.

Q. What are the Company's expected long-term debt issuances in the next several years?

A. To provide adequate funding for the significant capital expenditures noted in Section III above and to repay maturing long-term debt, we are forecasting the issuance of long-term debt every year for the next several years, as shown in Exhibit No. 2, Confidential Schedule 2C.

Q. Are there other debt obligations that the Company must consider?

A. Yes. In addition to long-term debt, the Company's $400 million revolving credit facility expires in April 2021. The Company relies on this credit facility to provide, among other things, funding to cover month-to-month variations in cash flows, interim funding for capital expenditures, and credit support in the form of cash and letters of credit that are required for energy resources commitments and other contractual obligations. Our credit facility was amended in May 2016, which stretched the expiration date to April 18, 2021, five years past the amendment date. The extension also allows amortization of fees over a longer time horizon, which decreased the monthly expense.

We expect to initiate the renewal or replacement of the credit facility before the existing arrangement expires. Any outstanding balances borrowed under the revolving credit facility become due and payable when the facility expires. Again, a strong financial position will be necessary to gain access to a new or renewed revolving credit facility prior to expiration of the existing facility.

V. CAPITAL STRUCTURE

Q. What capital structure and rate of return does the Company request in this proceeding?

A. Our requested capital structure is 50.0 percent debt and 50.0 percent equity with a requested overall rate of return in this proceeding of 7.81 percent, as shown in Illustration No. 4 below. The requested capital structure is consistent with that currently authorized (per Case No. AVU-E-16-03).

Illustration No. 4

AVISTA CORPORATION
Proposed Cost of Capital

	Proposed Structure	Cost	Component Cost
Total Debt	50.0%	5.72%	2.86%
Common Equity	50.0%	9.90%	4.95%
Total	100.0%		**7.81%**

Q. Is the capital structure reflected in Illustration No. 4 above calculated in a manner similar to the capital structure calculated in Avista's recent rate proceedings?

A. Yes. This methodology includes long-term debt and equity outstanding for Avista Corp., including the impact of costs related to the issuance of that debt and equity.

Debt and equity for AERC[2], which was acquired in mid-2014, are excluded from this calculation and do not impact the capital structure calculation for this rate proceeding.

Q. How does the Company determine the amount of long-term debt and common equity to be included in its capital structure?

A. As a regulated utility, Avista has an obligation to provide safe and reliable service to customers while balancing fiscal safety and economy, in both the short term and long term. Through our planning process we determine the amount of new financing needed to support our capital expenditure programs while maintaining an optimal capital structure that balances and supports our current credit ratings and provides flexibility for anticipated future capital requirements.

Q. Why is the Company proposing a 50.0 percent equity ratio?

A. On December 31, 2016, Avista's common equity percentage for the Idaho jurisdiction was 49.9 percent. The Company continues to evaluate the extent and timing of equity issuances for 2017-2021, taking into account our capital

[2]On July 1, 2014, the Company acquired Alaska Energy and Resources Company (AERC). AERC's primary subsidiary is Alaska Electric Light and Power Company (AEL&P), a wholly-owned corporation of AERC and a vertically integrated electric utility providing electric service to the City and Borough of Juneau. AERC and AEL&P are separate legal entities and their debt is backed by the assets and equity of AERC and AEL&P.

expenditures and other financial requirements. These steps to manage our equity level are expected to result in a common equity level of 49.9% at December 31, 2017, as shown on page 5 of Exhibit No. 2, Schedule 1.

Maintaining a 50.0 percent common equity ratio has several benefits for customers. We are dependent on raising funds in capital markets throughout all business cycles. These cycles include times of contraction and expansion. A solid financial profile will assist us in accessing debt capital markets on reasonable terms in both favorable financial markets and when there are disruptions in the financial markets.

Additionally, a 50.0 percent common equity ratio solidifies our current credit ratings and moves us closer to our long-term goal of having a corporate credit rating of BBB+. A rating of BBB+ would be consistent with the natural gas and electric industry average, which I will further explain later in my testimony. We rely on credit ratings in order to access capital markets on reasonable terms. Moving further away from non-investment grade (BB+) provides more stability for the Company, which is also beneficial for customers. We believe our requested 50.0 percent equity appropriately balances safety and economy for customers.

Q. In attracting capital under reasonable terms, is it necessary to attract capital from both debt and equity investors?

A. Yes, it is absolutely essential. As a publicly traded company we have two primary sources of external capital: debt and equity investors. As of December 31, 2016, we had approximately $3.15 billion of debt and equity. Approximately half of our capital structure is funded by debt holders and the other half is funded by equity investors and retained earnings. Rating agencies and potential debt investors tend to place significant emphasis on maintaining strong financial metrics and credit ratings that support access to debt capital markets under reasonable terms. Leverage – or the extent that a company uses debt in lieu of equity in its capital structure – is a key credit metric and, therefore, access to equity capital markets is critically important to long-term debt investors. This emphasis on financial metrics and credit ratings is shared by equity investors who also focus on cash flows, capital structure and liquidity, much like debt investors.

The level of common equity in our capital structure can have a direct impact on investors' decisions. A balanced capital structure allows us access to both debt and equity markets under reasonable terms on a sustainable basis. Being able to choose specific financing methods at any given time also allows the Company to take advantage of better choices that may prevail as the relative advantages of debt or equity markets can ebb and flow at different times.

Q. Are the debt and equity markets competitive markets?

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 equal to or better than investors' other alternatives. We are competing with not only other utilities but also with businesses in other sectors of the economy. Demand for our stock supports our stock price, which provides us the opportunity to issue additional shares under reasonable terms to fund capital investment requirements.

Q. What is Avista doing to attract equity investment?

A. We are requesting a capital structure that provides us the opportunity to have financial metrics that offer a risk/reward proposition that is competitive and attractive for equity holders. We target a dividend payout ratio that is comparable with other utilities in the industry. This is an essential element, along with potential growth, in providing a competitive risk/reward opportunity for equity investors.

Tracking mechanisms, such as the Fixed Cost Adjustment, the Power Cost Adjustment and the Purchased Gas Adjustment approved by the IPUC, and similar mechanisms approved by

Avista's other regulatory commissions, help 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.

VI. PROPOSED RATE OF RETURN

Q. Has Avista prepared an exhibit that includes the components of Avista's requested rate of return of 7.81 percent?

A. Yes. Exhibit No. 2, Schedule 1, page 2 shows the components of Avista's requested rate of return of 7.81 percent.

Q. What is the Company's overall cost of debt?

A. Our requested overall cost of debt is 5.72 percent. We have continued to issue debt with varying maturities to balance the cost of debt and the weighted average maturity. This practice has provided us with the ability to take advantage of historically low rates on both the short end and long end of the yield curve.

The Company's credit ratings have supported reasonable demand for Avista debt by potential investors. We have further enhanced credit quality and reduced interest cost by issuing debt that is secured by first mortgage bonds.

We plan to continue issuing long-term debt with various maturities for the foreseeable future in order to fund our capital expenditure program and long-term debt maturities.

There are a number of factors that should be taken into consideration in choosing the term of new debt issuances. For example, in the current interest rate environment where the interest rate spread for 30-year and 10-year terms is relatively narrow (i.e. presently there is a low premium for 30-year debt versus 10-year debt), would support increased reliance on longer-term debt.

In addition, much of Avista's utility assets are long-lived assets. A 30-year term for debt is a closer match to the average life of the underlying assets that are being financed. Decisions on the term of the debt are generally made closer to the time that new debt is issued. Based on information available today, the issuances of debt in 2018 will likely be heavily weighted toward a 30-year term, due in large part to the matching of the financing to the life of the assets being financed, and the narrow rate spread for 30-year vs 10-year terms.

The Company's credit ratings have supported reasonable demand for Avista debt by potential investors. We have further enhanced credit quality and reduced interest cost by issuing debt that is secured by first mortgage bonds.

Q. What is the Company doing to mitigate interest rate risk related to future long-term debt issuances?

A. As mentioned earlier, we are forecasting $2 billion in capital expenditures over the next five years. Additionally, we have $654.5 million of debt maturing during the same period. This results in a significant need for the issuance of long-term debt to fund these capital expenditures and maturing debt while maintaining an appropriate capital structure.

We usually rely on short-term debt as interim financing for capital expenditures, with issuances of long-term debt in larger transactions approximately once a year. As a result, we access long-term debt capital markets on limited occasions, so our exposure to prevailing long-term interest rates can occur all at once rather than across market cycles. To mitigate interest rate risks, we hedge the rates for a portion of forecasted debt issuances over several years leading up to the date we anticipate each issuance.

We also manage interest rate risk exposure by limiting the extent of outstanding debt that is subject to variable interest rates rather than fixed rates. In addition, we issue fixed rate long-term debt with varying maturities to manage the amount of debt that is required to be refinanced in any period (looking ahead to its future maturity), and to obtain rates across a broader spectrum of prevailing terms which tend to be priced at different interest rates.

Q. Does the Company have guidelines regarding its interest rate risk management?

A. Yes. The Company's Interest Rate Risk Management Plan, attached as Exhibit No. 2, Confidential Schedule 3C, is designed to reduce uncertainty of the effective interest cost of future debt issuances. The plan provides guidelines for hedging a portion of interest rate risk with financial derivative instruments. We settle these hedge transactions for cash simultaneously when a related new fixed-rate debt issuance is priced in the market. The settlement proceeds (which may be positive or negative) are amortized over the life of the new debt issuance.

The interest rate risk management plan provides that hedge transactions are executed solely to reduce interest rate uncertainty on future debt that is included in the Company's five-year forecast[3]. The hedge transactions do not involve speculation about the movement of future interest rates.

Q. The Company is requesting a 9.9% return on equity. Please explain why the Company believes this is reasonable.

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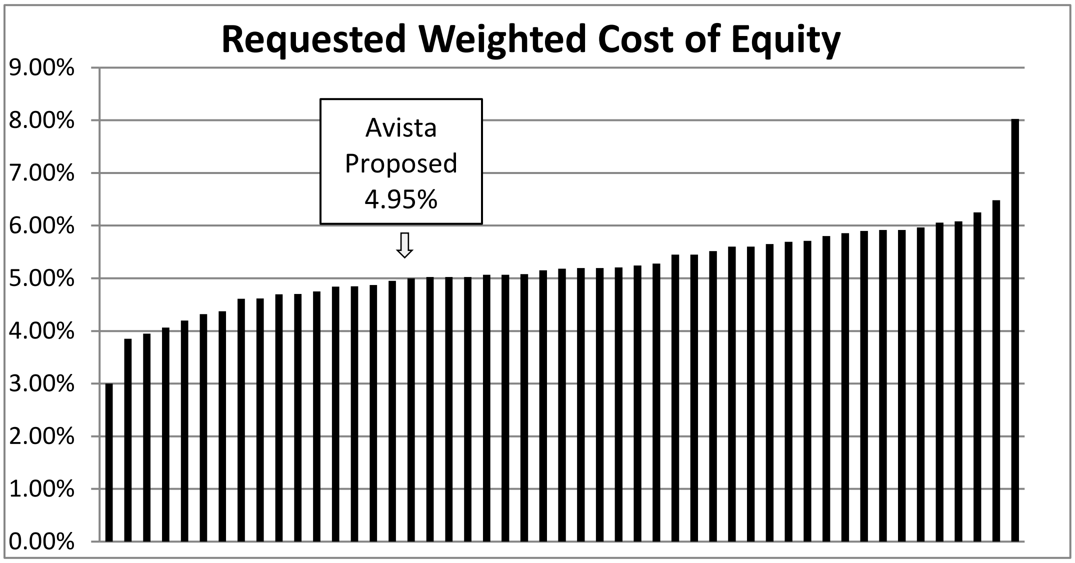
[3] The interest rate risk management plan also provides for the Company to hedge interest rate risk beyond the five-year horizon in some situations.

A. We agree with the analyses presented by Mr. McKenzie which demonstrate that the proposed 9.9 percent ROE, together with the proposed equity layer of 50.0%, would properly balance safety and economy for customers, provide Avista with an opportunity to earn a fair and reasonable return, and provide access to capital markets under reasonable terms and on a sustainable basis.

Q. How does Avista's requested 4.95 percent weighted cost of equity compare with the weighted cost of equity recently requested by electric and natural gas utilities in other jurisdictions?

A. Chart No. 2 below shows the weighted cost of equity requested and pending by investor-owned utilities across the country, for the twelve-month period from May 1, 2016 through April 30, 2017.

Chart No. 2[4]



Avista's proposed weighted cost of equity of 4.95 percent, which is also shown in the chart above, is in the lower half of the range of these weighted cost of equity numbers. Additional details related to this chart, including the names of the utilities, are provided in Exhibit No. 2, Schedule 4.

Because Avista competes with other utilities for equity investor dollars, it is essential for Avista to be able to provide an earnings opportunity that is competitive with other utilities.

VII. CREDIT RATINGS

Q. How important are credit ratings for Avista?

A. Utilities require ready access to capital markets in all types of economic environments. The capital intensive

[4] Source – SNL Financial, Rate Cases pending May 1, 2016 through April 30, 2017.

nature of our business, with energy supply and delivery dependent on costly long-term projects to fulfill our obligation to serve customers, necessitates the ability to obtain funding from the financial markets under reasonable terms at regular intervals. In order to have this ability, investors need to understand the risks related to any of their investments. Financial commitments by our investors generally stretch for many years – even decades – and the potential for volatility in costs (arising from energy commodities, natural disasters and other causes) is a key concern to them. To help investors assess the creditworthiness of a company, nationally recognized statistical rating organizations (rating agencies) developed their own standardized ratings scales, otherwise known as credit ratings. These credit ratings indicate the creditworthiness of a company and assist investors in determining if they want to invest in a company and its comparative level of risk compared to other investment choices.

Q. Please summarize the credit ratings for Avista.

A. Avista' credit ratings, assigned by Standard & Poor's (S&P) and Moody's Investor Service (Moody's) are as follows:

	S&P	**Moody's**
Senior Secured Debt	A-	A2
Corporate Credit Rating	BBB	Baa1
Outlook	Stable	Stable

Additional information on our credit ratings has been provided on page 1 of Exhibit No. 2, Schedule 1.

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

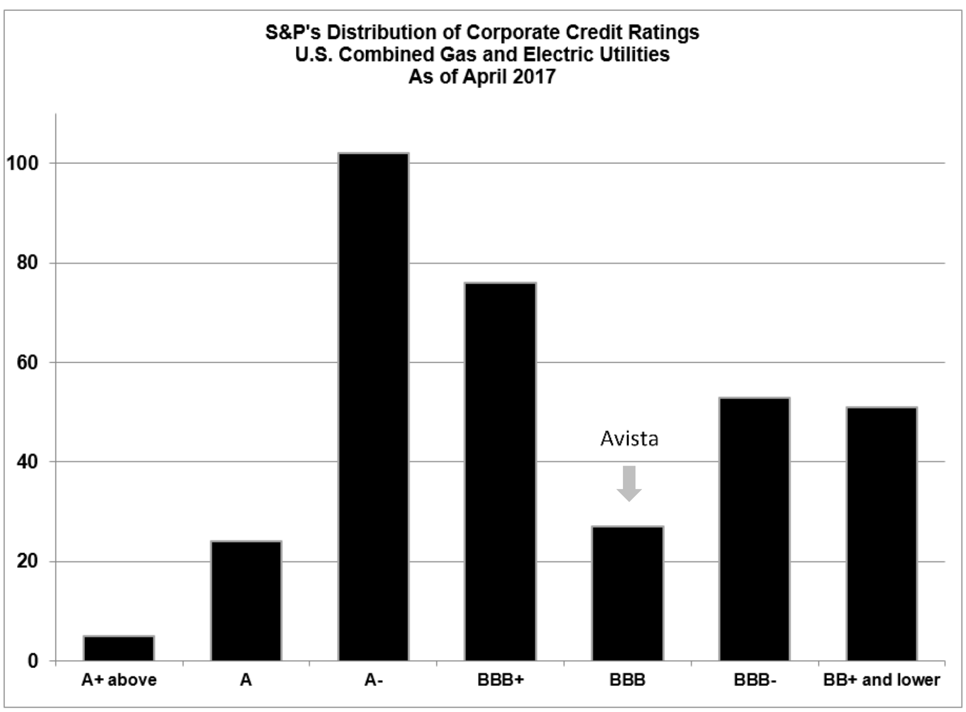
A. Credit ratings impact investor demand and expected returns. More specifically, when we issue debt, the credit rating can affect the determination of the interest rate at which the debt will be issued. The credit rating can also affect the type of investor who will be interested in purchasing the debt. 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 for payment of principal and interest in the event that the organization experiences severe financial stress. Investment risks include, but are not limited to, liquidity risk, market risk, operational risk, regulatory risk, and credit risk. These risks are considered by S&P, Moody's and investors in assessing our creditworthiness.

In challenging credit markets, where investors are less likely to buy corporate bonds (as opposed to U.S. Government bonds), a stronger credit rating will attract more investors, and a weaker credit rating could reduce or eliminate the number of potential investors. Thus, weaker credit ratings may result in a company having more difficulty accessing capital markets and/or incurring significantly higher costs when accessing capital.

Q. What credit rating does Avista believe is appropriate?

A. Avista's current S&P corporate credit rating is BBB. We believe operating at a corporate credit rating level (senior unsecured) of BBB+ is comparable with other US utilities providing both electricity and natural gas. As shown in Illustration No. 6, the average credit rating for U.S. Regulated Combined Gas and Electric Utilities is BBB+ and the most common rating is A-. The average and most common ratings are one and two notches higher, respectively, than Avista's rating.

<u>Illustration No. 6</u>



We expect that a continued focus on the regulated utility, conservative financing strategies and a supportive regulatory environment will contribute toward an upgrade to a BBB+ corporate credit rating for Avista. Operating with a BBB+ credit rating would likely attract additional investors, lower our debt pricing for future financings, and make us more competitive with other utilities. In addition, financially healthy utilities are better able to invest in the required infrastructure over time to serve their customers, and to withstand the challenges facing the industry and disruptions in the financial market.

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

A. Both Moody's and S&P cite the regulatory environment in which a regulated utility operates as the dominant qualitative factor to determine a company's creditworthiness. Moody's rating methodology is based on four primary factors. Two of those factors – a utility's "regulatory framework" and its "ability to recover costs and earn returns" – make up 50 percent of Moody's rating methodology[5].

S&P states the following[6]:

[5]Moody's Investors Service, Rating Methodology: Regulated Electric and Gas Utilities, December 23, 2013.
[6]Standard and Poor's, Key Credit Factors: Business and Financial Risks in the Investor-owned Utility Industry, March 2010.

> Regulation is the most critical aspect that underlies regulated integrated utilities' creditworthiness. Regulatory decisions can profoundly affect financial performance. Our assessment of the regulatory environments in which a utility operates is guided by certain principles, most prominently consistency and predictability, as well as efficiency and timeliness. For a regulatory process to be considered supportive of credit quality, it must limit uncertainty in the recovery of a utility's investment. They must also eliminate, or at least greatly reduce, the issue of rate-case lag, especially when a utility engages in a sizable capital expenditure program.

Because of the major capital expenditures planned by Avista and future maturities of long-term debt, a supportive regulatory environment is essential in maintaining our current credit rating.

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

A. Yes.