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STATE OF WASHINGTON
UTILITY AND TRANSPORTATION
COMMISSION

June 6, 2002

State of Washington
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Drive SW
Olympia, Washington 98504-7250

Attention: Ms. Carole Washburn, Executive Director

RE: Company Statements regarding Settlement Stipulation in Docket No. UE-011595

Please find enclosed for filing with the Washington Utilities and Transportation Commission ten (10) copies of the prepared statements of Mr. Kelly O. Norwood, Vice-President, Rates and Regulation and Mr. Jon E. Eliassen, Senior Vice-President and Chief Financial Officer, regarding the all-party Stipulation filed with the Commission on May 31, 2002 in the above referenced docket.

These statements were filed made by facsimile with hardcopy filing made via overnight mail. Questions regarding this filing should be directed to me at (509) 495-4326.

Sincerely,

A handwritten signature in black ink that reads "Don Falkner". The signature is written in a cursive, flowing style.

Don M. Falkner
Manager, Revenue Requirements

c: Service list

June 6, 2002

**Prepared Statement of Kelly O. Norwood
Vice-President, Rates and Regulation
Avista Utilities**

RE: Docket UE-011595 - Settlement Stipulation

I. Introduction

My name is Kelly O. Norwood and I am Vice-President of Rates and Regulation at Avista Utilities. At the outset I would like to express my appreciation to all parties involved in this proceeding, as well as Judge Bob Wallis, for their cooperation, good faith and commitment toward a collaborative resolution of the remaining issues in the Company's General Rate Case filed on December 3, 2001.

My comments are intended to provide the Commission additional information to assist in their decision regarding the approval of the proposed Settlement Stipulation ("Stipulation") filed with the Commission on May 31, 2002. However, before I begin my statement, I would like to commend the Commission Staff on their "Memorandum," filed June 3, 2002, explaining the Stipulation. It provided a very complete presentation of the regulatory history preceding the signing of this all-party Stipulation, the review and analysis process performed by the Staff, the issues resolved and the reasons Staff believes that the Stipulation is in the public interest. Because of the thoroughness of Staff's comments, I will abbreviate my comments to some degree.

I would like to provide a brief overview of the operational and regulatory challenges of the past two years and how they have been met, why this Stipulation is an additional necessary component in rebuilding the Company's financial health, and the benefits of the Stipulation. Mr.

Jon Eliassen, Avista Corp.'s Senior Vice-President and Chief Financial Officer, will be providing a review of the financial challenges and the steps taken to address them, the need to restore the Company's credit rating to investment grade, why this Stipulation is key to our next steps, and why this Stipulation is in the public interest.

II. The Stipulation Strikes an Appropriate Balance of Interests

- A. Customers: As the Staff Memorandum noted, the Company's customers will benefit from a degree of rate certainty by avoiding an additional increase in rates in this proceeding, continuation of prior rate impact mitigation measures, and ultimately would benefit from the opportunity for the Company to return to an investment grade credit rating.
- B. Investors: The investment community, who ultimately determine the Company's costs of financing its operations, would see a continuation of regulatory support for energy utilities in the state of Washington. Resolution of the recovery of deferred power costs, revenue increases associated with recovery of new resources necessary for service to customers, and an appropriate sharing of energy cost recovery risks through implementation of the Energy Recovery Mechanism ("ERM") are key to the Company's ability to restore our financial standing and address future risks.
- C. Community and Employees: The financial viability of the Company affects not only our customers, but also the communities in which we serve and our employees. Avista has a long-standing tradition as a strong institutional member of the communities in which it serves and employs approximately 1,400 employees throughout its service territories.

III. Challenges of the Past Two Years

The extraordinary situation in the Western energy markets beginning in 2000 and

continuing into 2001, coupled with unprecedented adverse hydroelectric conditions in 2001, placed the Company and its stakeholders in the position of trying to address one of the Company's greatest financial challenges in its 112-year history. With financing options limited and concerns from credit rating agencies, the Company undertook extraordinary measures to control costs, many of which have been outlined in the Company's filing in this case. In addition, it was necessary for the Company to make a number of regulatory filings in a relatively short period of time. Following is a brief review of those filings:

- A. Surcharge Filing (Docket UE-010395): The Company filed a petition on July 18, 2001 requesting recovery and amortization of power cost deferrals that had severely strained the Company's ability to continue to finance ongoing utility operations. Ultimately, a 25% surcharge was authorized effective October 1, 2001. A final prudence determination of the deferrals was to be determined as part of a later filing. Thus, any amounts recovered from customers through this surcharge were subject to refund. Finally, power cost deferrals were to be discontinued as of December 31, 2001.
- B. Prudence Petition (Docket UE-011514): The Company filed a petition on November 9, 2001 requesting a determination that the Company's deferred power costs through September 30, 2001 were prudently incurred and recoverable. Through approval by the Commission of the Stipulation crafted by all parties involved in the proceeding, 90%, or approximately \$196 million out of \$218 million of power costs deferrals through the end of 2001, was determined to be prudent and recoverable from customers. The Commission approved this stipulation on March 4, 2002. The Company subsequently wrote-off the remaining approximately \$22 million in power cost deferrals to 2001 earnings.
- C. Accounting Order (Docket No. UE-011597): The Company, through a request for an

accounting order filed December 3, 2001, petitioned the Commission for authorization to continue to defer power costs differences above or below that authorized in current rates for later recovery. The request was for the time period beginning January 1, 2002 and continuing through the conclusion of the Company's general case, which is described below. This request was approved by the Commission on December 20, 2001.

- D. Interim Rate Relief (Docket No. UE-011595): As part of the general rate case filing, also made on December 3, 2001 and described below, the Company petitioned for an Interim Electric Rate Increase of approximately 12.4% over base rates to be effective March 15, 2002. The Interim request portion of this Docket was consolidated with the Prudence Petition (UE-011514) described in (B.) above for hearing and scheduling purposes, and a settlement of the Interim request for an increase of 6.2% was reached and incorporated in the same all-party stipulation approved by the Commission on March 4, 2002. The new rates became effective March 6, 2002.
- E. General Rate Case (Docket No. UE-011595): The Company filed a general rate case on December 3, 2001 requesting that base rates be increased 22.5% and that the surcharge tariff be decreased to 14.9% from the previously approved 25%. As part of this filing the Company requested that the Commission determine that the 2002 power cost deferrals be recoverable and that the temporary deferral mechanism be replaced by a Power Cost Adjustment mechanism, or PCA. The Stipulation filed May 31, 2002 would resolve all of the remaining issues in this Docket.

Speaking for myself, as well as the Company, we would like to express our appreciation to the parties in these proceedings for recognizing the significant financial challenges facing our Company. The parties have worked diligently and efficiently to provide balanced solutions to

address the uncertainty surrounding the recoverability of power costs that we have incurred, and the resources we have acquired to meet customer needs, now and into the future. Additionally, we appreciate the Commission's timely responses to our surcharge, interim and prudence filings that have allowed us to get to this point in time.

This Stipulation completes a regulatory process that has been ongoing through most of 2001 and now well into 2002, and if approved, will allow the Company an opportunity to continue to recover the costs incurred to provide safe and reliable energy service to our customers.

IV. Benefits of the Settlement

There are several significant benefits to the Stipulation that the Company believes strongly support a determination that approval of the Stipulation is in the public interest. First and foremost for customers, there would be no further increases in rates as a result of this Stipulation, apart from a minor adjustment to Schedule 25. The Company is mindful of the impact on customers of the recent price increases, since October 1, 2002, totaling 31.2%. As also discussed by Mr. Eliassen, the Company believes that the avoidance of an additional rate increase to customers at this time, through reallocation of the existing overall increase of 31.2%, is reasonable with respect to balancing the two competing objectives of restoring the financial health of the Company with the overall rate impact to customers.

The energy surcharge of 25% effective October 1, 2001, Schedule 93, provided an annualized revenue increase of \$59.2 million to begin recovery of the deferred power cost balance. The Interim rate increase effective March 6, 2002, Schedule 96, produced an additional annualized revenue increase of \$14.7 million, or 6.2%, to offset ongoing general operating costs of the Company. As part of the Interim and Prudence Settlement Stipulation, a portion of the surcharge

revenues, one-fifth of the 25% surcharge or approximately \$11.8 million, was also directed to offset general operating costs. Therefore, of the overall 31.2% increase in rates implemented since October 1, 2001, 11.2% currently applies to ongoing operating costs of the Company and 20% to recovery of the deferral balance.

If the Commission accepts the recommendation of all the parties and approves the Stipulation as filed, \$45.7 million (19.3%) would be reallocated as an increase to the Company's base general rate schedules, and \$28.2 million (12.9%) would continue as an energy surcharge to reduce the balance of power cost deferrals. Schedule 96, the Interim general rate increase tariff would be eliminated immediately. The energy surcharge Schedule 93 would be eliminated when the energy cost deferral balance reaches zero, resulting in potentially a 10% decrease in rates.

Included as an exhibit to this statement is a graphical timeline representing the rate changes I have just described, including the effect of the proposed Stipulation.

Customers also will benefit from the continuation of rate impact mitigation measures such as a Winter Low-Income Payment Program, Comfort Level Billing Plan changes and eased Deposit Requirements. As part of the Stipulation, the Company has agreed to make annual contributions of \$150,000 to Project Share until the deferred energy cost balance is reduced to zero, which is currently projected to occur in 2007. Project Share provides emergency energy assistance for Washington families.

The implementation of an Energy Recovery Mechanism ("ERM") is an important step to the Company's return to an investment grade credit rating and lower costs of financing. The lack of such a mechanism has consistently been identified as a concern by financial rating agencies.

The ERM is very similar to the Company's power cost adjustment (PCA) mechanism in effect in our Idaho jurisdiction, with the exception of the introduction of a "Company Band," or

Band, which must be exceeded before differences in power costs are deferred. The mechanics and the details of the ERM are outlined by the Staff in their Memorandum. The Band proposed in the Stipulation together with the deferral of 90% of the power costs differences, plus or minus, that exceed the Band, is the result of an attempt by all Parties in this proceeding to balance the risk and return (reward) to the Company, as well as the risk and costs to customers. Additionally, the Band coupled with the 90% customer / 10% Company sharing mechanism provides an incentive for the Company to continue to make resource decisions that are in the best interest of both the Company and its customers. We believe that the ERM, as currently proposed, provides an appropriate compromise on sharing the risk between the Company and its customers.

From a financial standpoint, which Mr. Eliassen will also address, the ERM would add stability to the Company's operating results and would provide a measure of certainty regarding recovery of power costs, which would be viewed positively by members of the investment community. Over time this should result in improved financial indicators and lower overall financing costs, which would ultimately benefit Avista's customers.

Resolution of the uncertainty associated with the regulatory treatment to be afforded the costs of new long-term resources, such as the Coyote Springs II and Boulder Park generation projects, as well as the power cost deferrals beyond December 31, 2001, are both key steps for the Company as it continues to manage its power supply resource decisions necessary for providing service to our customers.

Finally, the Stipulation resolves all remaining revenue requirement issues as filed by the Company, including power supply and power supply modeling issues that were identified by the Commission in its final order in Docket No. UE-991606 to be addressed by the Company.

V. Summary

In summary, approval of the Stipulation will complete an extensive regulatory process that effectively began in 2000. During that period the Western energy markets went through extraordinary periods of volatility and high prices, ultimately requiring governmental intervention. Furthermore, the Company along with much of the Northwest experienced record or near record low streamflow levels which severely reduced hydroelectric generation. Approval of the Stipulation by the Commission would resolve the remaining issues in this case related to the recovery of previously incurred costs, as well as the recovery of the ongoing costs of providing service. Resolution of these issues would provide a sound foundation for the Company to move forward in its plans to regain investment grade status, while continuing to provide safe, reliable and economic service to its electric customers in the long term.

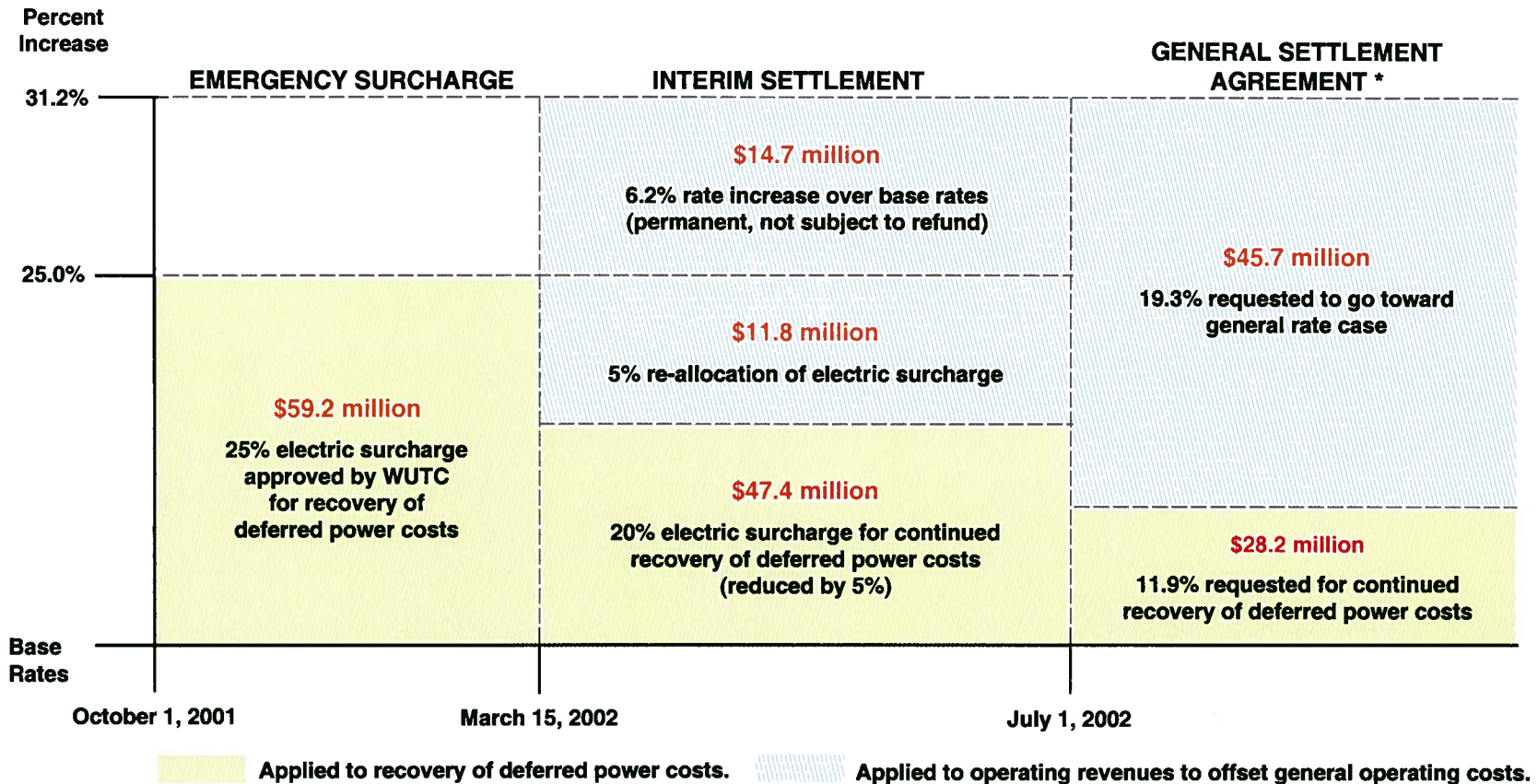
The Stipulation is the result of extensive review, discovery, testimony and negotiation by all parties in this proceeding. In fact, the parties to this Docket (Public Counsel, Commission Staff and Industrial Customers of Northwest Utilities) have also been participants in all the prior proceedings that I outlined earlier. The Company believes that this Stipulation provides a fair and balanced resolution of the pending issues in this case, and as such is in the public interest. For these reasons, and others outlined in this statement, the Company respectfully requests that the Commission approve the Stipulation as filed and issue an order to allow for a timely compliance filing and implementation of new tariffs on July 1, 2002.



AVA General Rate Case Timeline

State of Washington
June 3, 2002

(Dollar amounts in red represent annualized totals.)



* All-party settlement reached May 31, subject to Washington Commission approval.

June 6, 2002

**Prepared Statement of Jon E. Eliassen
Senior Vice-President and Chief Financial Officer
Avista Utilities**

RE: Docket UE-011595 - Settlement Stipulation

I concur with Mr. Norwood's comments and I would also like to express my appreciation to all parties for their demonstration of cooperation, good faith and commitment that resulted in the settlement that we are discussing today.

I believe that the settlement proposal before the Commission today is a key step in rebuilding the Company's financial health to a level that is critical for the long-term benefit of our customers, communities and investors.

As we have previously outlined for you, the events of the past two years have caused a severe strain on the Company's financial condition. The Company was required to finance deferred power costs in unprecedented amounts and in the face of uncertainty about the ability to ultimately recover those costs. The worst hydro generation conditions in over 70 years, combined with unpredicted energy price levels and volatility, general turmoil in the energy industry, the lack of an established power cost recovery mechanism in our primary jurisdiction, and other factors, ultimately resulted in the Company's credit rating being reduced to below investment grade.

I believe we have made significant progress over the past nine months in addressing our financial condition. The regulatory action and support received to date from this Commission has been a critical part of that progress. In particular, the surcharge implemented last fall was a

key action that provided improved cash flows necessary to allow the Company to reduce the amount of money being borrowed to pay for power purchases. The deferral accounting order, prudence settlement and interim rate increase orders granted earlier this year have all been recognized by the financial community as positive steps by this Commission that show its commitment to the financial health of regulated utilities in Washington.

Based on the strength of these orders, the Company has been able to renew and actually increase its corporate line of credit, which was set to expire on May 31, 2002. In addition, we have been able to renew and increase the Accounts Receivable financing program and thereby retain one of the lowest cost sources of financing available to the Company. And, since the beginning of this year we have been able to begin to repurchase some of our outstanding higher cost debt which will reduce leverage and improve interest coverage ratios over time

Even so, these actions to date have not yet been sufficient to improve the Company's credit rating. Moody's and Standard & Poor's still have the Company rated below investment grade with a negative outlook. Changing that outlook and the credit rating depends in large part on reasonable resolution of the issues in this General Rate Case.

The settlement proposal before you addresses key factors that I believe will ultimately support an improvement in the Company's credit rating. Specifically:

- The additional revenue requirement to cover new resource costs and operating costs will support improved financial indicators....indicators that over time will support an investment grade credit rating. Accomplishing this additional revenue requirement, without another incremental rate increase to our customers, provides a necessary balance between the Company's financial needs and our customers' ability to bear more rate increases.
- The settlement results in no additional immediate write-offs, which is critical to maintain the debt ratio.
- The settlement provides for certainty of recovery of the remaining previously deferred power costs.

- The Energy Recovery Mechanism (ERM) will be viewed as a significant positive step for our recovery of credit quality.

In the opinion of lenders and rating agencies, the ERM will provide better stability and predictability to the Company's cash flows and earnings, reduce the risks associated with exposure to very unpredictable power markets, and will ultimately result in lower financing costs in the future. I don't believe we will see an immediate credit rating upgrade, but I'm very hopeful we could see a change in the next 12-18 months.

Overall, the settlement proposed today bring us much closer to being able to demonstrate that the business risk profile of the Company is being positively addressed by Company and regulatory Commission actions. Assurance of recoverability of certain expenses, rate base treatment of new generation facilities, and the ERM process will support our position that the business risk of the Company has been reduced and is again in line with the operating risk profile we enjoyed two or three years ago. In time, this will help significantly in our efforts to restore our credit ratings to acceptable levels.

To date, the reaction to the announcement of the settlement agreement from rating agencies has been positive. Standard & Poor's in a research report dated June 3, 2002, stated:

“Standard & Poor's noted that today's announcement by Avista Corp. (BB+/Negative/--) that it has reached an agreement with all parties in its Washington State rate case filing is a positive event for the Company's credit quality. The parties have requested that the Washington Utilities and Transportation Commission (WUTC) approve the agreement to become effective July 1, 2002. One of the more important aspects of the agreement is the Energy Recovery Mechanism, which operates like a power cost adjustment mechanism, and should partly mitigate the effect of volatile power prices on Avista's earnings and cash flow. On approval by the WUTC, Standard & Poor's will evaluate the full effect of the agreement on Avista's credit profile.”

Other analysts following the Company have made similar observations.

We still have work to do. The Company will continue to focus on controlling costs, both O&M and Capital. The hiring freeze implemented in mid-2001 is still in place. We will continue to evaluate the viability of and need to issue Common Stock. We will work with rating agencies to demonstrate them that our Business Risk profile has improved, in particular as related to the support the utility has received from regulators over the past year.

I want to thank the Commission for it's timely actions supporting the Company in this very difficult period. Your support has been critical in allowing the Company to maintain access to capital and in particular, renew its short-term credit facilities. I am confident that approval of the settlement proposal in this case will be one more critical step that will give us an opportunity to restore Avista's financial integrity and to continue to provide reliable service at reasonable rates.