BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-17\_\_\_\_\_\_\_\_

DOCKET NO. UG-17\_\_\_\_\_\_\_\_

DIRECT TESTIMONY OF

MARK T. THIES

REPRESENTING AVISTA CORPORATION

# 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 our credit ratings and the Company’s proposed capital structure and overall rate of return in this case. Company witness Mr. McKenzie 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. I will provide an overview of our capital expenditures program, and other witnesses will provide details on what capital expenditures we are making, and why they are necessary in the time frame in which they are planned.

In brief, I will provide information that shows:

1. 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.
2. We are proposing an overall rate of return of 7.69 percent, which includes a 50 percent common equity ratio, a 9.9 percent return on equity, and a cost of debt of 5.62 percent. We believe our proposed overall rate of return of 7.76 percent and the proposed capital structure provide a reasonable balance between safety and economy.
3. Avista’s plans call for a continuation of utility capital investments in generation, transmission and distribution systems and technology 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.

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

A. Yes. I am sponsoring Exh. MTT-2 pages 1 through 7, which were prepared under my direction. Avista’s credit ratings by S&P and Moody’s are summarized on page 1. Avista’s proposed capital structure and cost of capital are included on page 2, with supporting information on pages 3 through 7. Confidential Exh. MTT-3C is our Interest Rate Risk Management Plan. Exh. MTT-4 includes the equity ratios and returns on equity requested by investor-owned utilities from May 1, 2016, through April 30, 2017. Confidential Exh. MTT-5C shows the Company’s planned capital expenditures and long-term debt issuances by year.

**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 and 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. Language from Moody’s Credit Opinion on Avista Corporation issued on March 22, 2017 emphasizes the need for timely recovery of costs:[[1]](#footnote-1)

…Avista estimates that the delay in obtaining a rate order will reduce its earnings per diluted share between $0.20 to $0.30 for 2017. We estimate that this would equate to between $13 million and $20 million of net income. This reduction of net income could reduce cash flow to debt metrics by up to 100 basis points, or around 18 percent, assuming no increase in debt. We would expect this trend to correct itself once an acceptable general rate case is filed with the WUTC and becomes approved. However, should cash flow to debt remains in the mid-teen's percent range (e.g., 16 percent or 17 percent) there could be negative ratings pressure for Avista. (emphasis added)

From the Moody’s Credit Opinion, it is apparent that getting back on track in this rate case for Avista to have an opportunity to earn its allowed rate of return is very important. Avista has developed this case to respond to the specific concerns expressed by the Commission in the last rate case, through, among other things, addressing the timing and frequency of rate cases, the employment of familiar ratemaking tools (e.g., end of period rate base and adjusted capital structure), and by providing further explanation of why the Company is making expenditures in the time frame in which they are planned.

**Q. Please briefly explain how the Company has addressed the frequency and timing of rate cases, and the ratemaking tools employed in this case.**

A. As discussed by Company witnesses Mr. Morris and Ms. Andrews, the Company is proposing in this general rate case a Three-Year Rate Plan – requesting a base rate increase effective May 1, 2018, May 1, 2019 and May 1, 2020. With regard to the frequency and timing of rate cases, in recent years the Company has filed general rate cases in the first quarter of the year, and the rate adjustments resulting from the cases have generally been implemented in January, which is the middle of the winter heating season. The filing of the Three-Year Rate Plan in late May 2017, will have the effect of changing the “cycle” of base rate adjustments from the middle of winter to approximately May 1st of each year. The timing of this filing, together with the Three-Year Rate Plan, will avoid base rate adjustments for customers in the middle of winter for the next three years.

In addition, this Three-Year Rate Plan will provide a degree of rate predictability for customers, and a respite from the burdens and costs of the current pattern of continuous annual rate case filings for the Company, Staff, and other participants. The Three-Year Rate Plan will also provide an incentive for Avista to manage its costs in order to earn the authorized rate of return proposed in this filing over the rate plan period.[[2]](#footnote-2)

With regard to other ratemaking “tools” the Company has employed, Avista has included the use of End-Of-Period (EOP) rate base, as well as an adjusted capital structure in order to arrive at an end result revenue requirement that is fair for customers and sufficient for the Company.

Specifically, EOP rate base at the end of 12/31/2017 has been included in the Company’s’ request for rate relief. With a rate effective date of May 1, 2018, the inclusion of plant as of December 31, 2017 allows parties to this proceeding, and this Commission, an opportunity to review rate base balances which are in service, and used and useful before rates go into effect May 1, 2018.[[3]](#footnote-3)

The Company has also used an adjusted capital structure in this case, reflecting 50 percent equity and 50 percent debt. The proposed capital structure in this case is calculated excluding short-term debt. An adjusted capital structure that is determined excluding short-term debt is also currently authorized for Avista in both Idaho and Oregon.

Coincident with this general rate case filing, the Company has filed a Power Cost Rate Adjustment (PCRA) to update base power supply costs effective September 1, 2017. As discussed by Company witness Mr. Ehrbar, resetting base power supply costs September 1, 2017 would increase Company revenues approximately $15 million, or 2.92%. The PCRA reflects changes in net power supply costs, including the expiration of the Portland General Electric (PGE) capacity sales contract, which expired December 31, 2016. In addition to the PCRA, as a part of the Three-Year Rate Plan, the Company is also proposing to file annual Power Cost Updates with the Commission on or before February 15, 2019 (for the May 1, 2019 update) and February 15, 2020 (for the May 1, 2020 update), as further explained by Mr. Johnson.

**Q. The Company reported earnings above expectations for first quarter 2017. Would you please explain the drivers of the increased earnings?**

A. Yes, the main driver of earnings above expectations was extraordinary high hydroelectric generation beginning in February and continuing through the end of March. Lower power supply costs contributed $0.06 per share to first quarter earnings. This extraordinary benefit, however, is not expected to continue for the balance of the year, and actual power supply costs for the full year of 2017 are expected to be significantly higher than the level currently authorized in base retail rates. This is why Avista has proposed the Power Cost Rate Adjustment effective September 1, 2017, as explained by Company witness Mr. Johnson.

A second primary reason for the earnings above expectations for the first quarter of 2017 is lower than expected operating costs. The majority of these lower costs, however, reflect a timing difference, and higher costs for the remainder of the year are expected to offset the lower costs experienced in the first quarter.

In Avista’s news release issued May 3, 2017, the Company confirmed its earnings guidance for calendar-year 2017, and referred to an “expected return on equity range for Avista Utilities of 7.4 percent to 7.8 percent in 2017.”

**III. CAPITAL EXPENDITURES**

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

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

**Chart 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 limits on proposed capital spending amounts for each year of the next five years, which is presented to the Finance Committee of the Board of Directors[[4]](#footnote-4).

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. Table No. 1 below shows the Company’s maturing long-term debt from 2018 through 2022. Within this five-year period, $272.5 million matures within the second quarter of 2018, and another $250 million within the second quarter of 2022.

**Table No. 1**

|  |
| --- |
| **Avista CorpLong-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 percent5.95 percent7.45 percent | 5/11/19934/3/20086/9/1993 | 5/11/20186/1/20186/11/2018 |
| 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 between ten 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 under reasonable terms, 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 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 confidential Exh. MTT-5C.

**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 daily and 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 under reasonable terms prior to expiration of the existing facility.

**V. PROPOSED CAPITAL STRUCTURE AND COST OF CAPITAL**

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

A. Our proposed capital structure is 50 percent debt and 50 percent equity, with a proposed cost of debt of 5.62 percent, a proposed 9.9 percent return on equity (ROE), and a requested overall rate of return (ROR) in this proceeding of 7.76 percent, as shown in Table No. 2 below.[[5]](#footnote-5) The proposed capital structure for the Three-Year Rate plan is calculated excluding short-term debt.

**Table No. 2**

**Q. Why is Avista proposing to exclude short-term debt from the capital structure calculation in this case?**

A. As explained by Mr. Morris and Ms. Andrews, the results from the Traditional Pro Forma Study will not yield the electric and natural gas rate relief necessary to provide the Company the opportunity to earn the proposed ROR requested in this case. One of the rate making “tools” identified by this Commission that can be used to arrive at an end result that provides sufficient revenues is the use of an adjusted capital structure.[[6]](#footnote-6) Both Idaho and Oregon currently use this ratemaking tool of adjusting the capital structure by excluding short-term debt from the calculation. Avista’s currently approved capital structure in Idaho and Oregon includes 50 percent equity and 50 percent debt. In this case Avista is proposing a similar adjustment to its capital structure, excluding short-term debt from the calculation. The calculation of the proposed capital structure is provided at page 6 of Exh. MTT-2.

**Q. Why is the Company planning to maintain an equity ratio at this level?**

A. Maintaining a 50 percent common equity ratio, excluding short-term debt, 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, this 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 the proposed 50 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. 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 and ROE that provide 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 decoupling, the Energy Recovery Mechanism and the Purchased Gas Adjustment approved by the 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.

**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 in a similar time frame. This results in a significant need for the issuance of long-term 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 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.

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), supports increased reliance on longer-term debt.

In addition, the average life of plant assets for Avista exceeds 30 years. 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, although the Company will consider some amount of 10-year debt in 2018, the issuances 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. Does the Company have guidelines regarding its interest rate risk management?**

A. Yes. The Company’s Interest Rate Risk Management Plan, attached as Confidential Exh. MTT-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. The hedge transactions do not involve speculation about the movement of future interest rates.

**Q. Please describe Avista's credit facility.**

A. We have a five-year credit facility in the amount of $400 million with a maturity date of April 18, 2021. The credit facility involves participation by ten banks. This credit facility was originally established in 2011 and it was amended in April 2014 and extended in May 2016. Our credit facility provides the ability to take out or repay short-term debt based on day-to-day liquidity needs and to have letters of credit issued on the Company’s behalf. The Company pays fees under three price elements in the agreement: 1) a facility fee to maintain the right to draw on the credit facility at any time, 2) interest on amounts borrowed, and 3) fees for letters of credit.

The Company may request letters of credit (LCs) underwritten by the participating banks and established for the benefit of counterparties to Avista. LCs are often used as collateral when required for energy resources forward commitments, forward swap transactions to hedge interest rate risk on future long-term debt, and other contractual or legal requirements that involve the Company. The maximum available for LCs is $200 million. The amount available for cash borrowing out of the overall $400 million credit facility is reduced by the amount of LCs outstanding.

Table No. 3 below summarizes the rates paid to maintain and use the credit facility.

**Table No. 3**

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The Pricing Level and associated rates that we are charged is based upon our underlying credit ratings as well as the security supporting the borrowings. Our current rates are based upon Pricing Level II, which became effective in February 2014 based on the Company’s improved credit ratings. We achieve this Pricing Level by securing the credit facility with First Mortgage Bonds. If we did not secure this credit facility with First Mortgage Bonds, the costs would be based on Pricing Level IV, which would increase costs to customers. There are also upfront costs paid for setting up the credit facility (i.e. legal arrangement, bank commitments) that are amortized over the term of the credit facility.

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

A. We agree with the analyses presented by Mr. McKenzie which demonstrate that the proposed 9.9 percent ROE[[7]](#footnote-7), together with the proposed equity layer of 50 percent, 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. The proposed weighted cost of equity is 4.95 percent (9.9 percent times 50 percent).

**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[[8]](#footnote-8)**

Avista’s proposed weighted cost of equity of 4.95 percent, which is also shown in the chart above, is in the lower third 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 Exh. MTT-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.

**VI. 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 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:



Additional information on our credit ratings has been provided on page 1 of Exh. MTT-2.

**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 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 Chart No. 3, 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.

**Chart No. 3**



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. As discussed earlier in my testimony, Moody’s March 2017 Credit Opinion emphasized the need for timely recovery of costs. 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[[9]](#footnote-9).

S&P states the following[[10]](#footnote-10):

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.

1. Moody’s Investors Service, Credit Opinion, “Avista Corp.: A Vertically Integrated Electric and Gas Utility”, March 22, 2017. [↑](#footnote-ref-1)
2. The term of the Three-Year Rate Plan would not preclude tariff filings authorized by or contemplated by the terms of the Energy Recovery Mechanism (ERM), Purchased Gas Adjustment (PGA), Public Purpose Rider Adjustment (DSM/LIRAP) or similar adjustments. The Company proposes that the Three-Year Rate Plan would also not preclude the Company from filing for rate relief or accounting treatment for major changes in costs, such as the potential costs associated with participation in the Energy Imbalance Market, or new safety or reliability requirements imposed by regulatory agencies. [↑](#footnote-ref-2)
3. Idaho and Oregon, for the past several rate cases, have approved planned end-of-period rate base balances for Avista, just prior to rates going into effect. For example, in Avista’s last Idaho electric general rate case (Case AVU-E-16-03), consistent with prior electric and natural gas cases in Idaho since 2008, the Idaho Commission approved rate base balances as of December 31, 2016, for rates effective January 1, 2017. [↑](#footnote-ref-3)
4. The Finance Committee is presented with a five-year plan, but approves the plan for only the next operating year. [↑](#footnote-ref-4)
5. The calculations of the proposed capital structure, cost of debt and overall cost of capital are provided with Exh. MTT-2. The calculation of the cost of debt includes $100 million of short-term debt. [↑](#footnote-ref-5)
6. The WUTC acknowledged at page 181 of its Order 08 in Docket No. UE-111048 and UG-111049 of Puget Sound Energy’s rate proceeding, the consideration of adjustments to rate base beyond the historical test period by stating they were open to considering “Use of plant accounts (rate base) measured at the end, or subsequent to the end of the test-year rather than the test-year average,” and their openness to consider an “upward adjustment to the equity share in the capital structure.” (emphasis added) [↑](#footnote-ref-6)
7. As stated by Mr. McKenzie, a 9.9 percent ROE is a conservative estimate of investors’ required ROE for Avista. [↑](#footnote-ref-7)
8. Source – SNL Financial, Rate Cases pending May 1, 2016 through April 30, 2017. [↑](#footnote-ref-8)
9. Moody’s Investors Service, Rating Methodology: Regulated Electric and Gas Utilities, December 23, 2013. [↑](#footnote-ref-9)
10. Standard and Poor’s, Key Credit Factors: Business and Financial Risks in the Investor-owned Utility Industry, March 2010. [↑](#footnote-ref-10)