BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-01__________

DIRECT TESTIMONY OF

RONALD R. PETERSON

REPRESENTING AVISTA CORPORATION

Q. Please state your name, employer, and business address.

A. My name is Ronald R. Peterson. I am employed as Vice President and Treasurer by Avista Corporation at 1411 East Mission Avenue, Spokane, Washington. I was recently appointed as Vice President and Controller of Avista Utilities, and will relinquish my role as Treasurer when a successor is named to that position.

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

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

I was named to my current position in August 2001 and I am currently serving in both the Corporate Treasurer and Utility Controller capacities during a transition period.

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

A. I will address the need for interim rate relief and whether the Commission's criteria for interim relief have been satisfied. I will explain covenants under the Company's financing arrangements and how they impact the Company. I will also explain the financial benefits of a power cost adjustment mechanism to Avista's customers and other stakeholders.

Q. Are you sponsoring exhibits with your testimony?

A. Yes. I am sponsoring Exhibit No.__ (RRP-1) as previously marked for identification.

Need for Interim Rate Relief

Q. Why does Avista need an interim rate increase?

A. There are several reasons why Avista needs interim rate relief as outlined below:

- Cash flows continue to be weak
- Renewal of short-term credit facilities that expire in May 2002 is essential
- The Company needs to begin to move its credit rating back to investment grade
- Issuance of equity is required to return to investment grade

I will discuss each of these and the impact that rate relief will have on each area.

Avista continues to be challenged with having enough cash flow – both in terms of quantity and certainty – to provide adequate liquidity to operate the business on a day to day basis. As Mr. Eliassen explains in his testimony, and as shown in Exhibit __ (JEE-5), the utility business has ongoing needs for capital and maturing debt totaling $148 million for the fourth quarter of 2001 and the first half of 2002. This is nearly $50 million more than the operating cash flows that are generated over the same period, so continued access to capital markets is critical. A key part to maintaining our liquidity is renewal of the $220 million corporate line of credit and renewal of the accounts receivable financing. Both of these agreements expire in May 2002. These agreements must remain in place as the projected balances at June 30, 2002 are expected to be approximately $93 million under the line of credit and $39 million under the accounts receivable program. Approval of interim rate relief in this filing will provide additional cash flows and is critical to Avista's success in renewing the accounts receivable financing and line of credit on reasonable terms.

Q. What are the projected earnings for the utility in 2002 assuming no interim or general rate increase is granted and no extension of the deferral mechanism?

A. The utility operations projected net income for 2002, absent extension of the deferral mechanism is expected to be approximately $8.9 million, or 34 cents per share. The return on equity would be approximately 2.3%.

Q. What impact would this earnings level have on the Company and its ability to complete a sale of equity?

A. Earnings at this level will result in additional deterioration of the Company's already weak financial condition and would make it impossible to sell equity at a reasonable price.

Q. What impact will an interim increase have on the Company's financial condition?

A. Exhibit No. __ (RRP-1), page 1, shows financial indicators for the Company without an interim increase. As shown on page 1, without any rate increase, Avista does not meet the range associated with BB ratings, let alone the minimum investment-grade standard of BBB. Page 2 shows the same indicators with an extension of deferrals and assuming an interim and general increase are granted. As shown on page 1, columns d and e, without the increases, the Company continues to be substantially <u>below investment grade in all categories</u> in 2002 and 2003. Resolution of the prudency case and granting of an interim increase will make it much more likely that the Company can complete actions that will improve the utility's financial condition. Positive rate actions will make it much easier for Avista Energy to obtain waivers to pay additional dividends and upstream cash to Avista Corp. (Restrictions prohibiting the upstreaming of dividends from Avista Energy to Avista Corp. were imposed by the Avista Energy banks after Avista Corp. was downgraded to below investment grade). These positive rate actions would also make it much more likely that the Company can sell some type of equity in 2002. Page 2, columns d and e, show the financial indicators including the cash impact of the rate relief, and assuming $90 million of cash is upstreamed from Avista Energy and $50 million of equity is sold by Avista Corp. in 2002. As can be seen, two of the four indicators are investment grade and the other two show substantial and continuous improvement so that by the end of 2003 they are very close to investment grade.

Q. Will an interim increase result in the Company earning its allowed rate of return?

A. No. It will take a series of events before the Company will have an opportunity to earn its allowed rate of return. These include: the ability to continue to defer power costs in 2002 until the general case is resolved, resolution of the prudence filing and recovery of deferred power costs, and the resolution of the general rate filing. If all of these issues are resolved as proposed by the Company, our expectation is that Avista would have an opportunity to earn the allowed rate of return in 2003 or 2004.

Q. The Company recently offered testimony in its prudence filing (Docket No. UE-011514) about the need for a determination of prudence for deferred power costs. How does the prudence filing, along with Avista's emergency power cost surcharge, fit into a need for interim rate relief in the current filing?

A. The prudency filing does nothing to address the immediate cash needs of the Company. In the prudence review filing, the Company requests that the Commission establish the prudence and recoverability of the deferred power costs incurred through September 30, 2001. The prudence filing essentially is intended to remove uncertainties that remain around the deferred costs (and the uncertainty related to the "subject to refund" aspect of the surcharge order). The prudence request does not address the actual timing of cash recovery of the remaining deferred costs.

The surcharge filing addressed a specific set of costs, namely those costs that were incurred that are over and above the amounts recovered in base rates as defined by the Commission's earlier deferred power cost accounting orders (Docket No. UE-000972). Although the surcharge increase granted will be helpful, the cash flow provided by the increase is not adequate to maintain the Company's financial health. As Mr. Eliassen explained in his testimony in the Company's prudence filing (Docket No. UE-011514), rating agencies and lenders have reacted negatively regarding the uncertainty surrounding the recoverability of deferred power supply costs. Since the surcharge only provides partial recovery of past deferred costs, the balance of deferred costs is still being carried by the Company at a substantial cost.

Q. What other uncertainties need to be addressed?

A. Avista's financial condition has also deteriorated in part because the increasing costs of serving customers exceeds what the Company is collecting from customers. Avista is experiencing a higher cost structure than existing base rates reflect. The present filing for a general rate increase addresses ongoing costs of operating the utility that are over and above the existing base rates. The capital investment in the utility has increased as substantial investment has been made in new generation; operations and maintenance costs have increased; the cost of power supply has increased along with changes to the resource mix that provides energy for electric customers; and, the cost of capital has increased significantly. However, recovery of these costs will not be resolved until late 2002.

The additional interim rate relief is needed to provide current cash flows that contribute toward underlying expenses of electric service, and to demonstrate to investors and lenders that Avista's financial condition will not be permitted to deteriorate further during the time involved in processing a general rate case. Because of Avista's weakened financial condition, the strain of carrying these costs until a general rate increase order is received will cause additional deterioration of Avista's financial condition. In this filing, the Company requests that the Commission grant interim rate relief that will increase cash inflows to the Company during the adjudication of the general rate filing. The downward pressure on the Company's financial condition must be stopped as quickly as possible. Ultimately the cost to serve customers will be higher for an extended future period if the Company's weakened financial condition is not addressed. As I mentioned earlier, an interim increase will also improve the Company's ability to renew credit agreements on reasonable terms. As discussed by Mr. Eliassen, the Company needs to complete the renegotiations of key terms, including covenants, prior to the expiration of both the bank credit line and the accounts receivable financing facility in the first part of 2002. It is critical that we take as much uncertainty off the table as soon as practicable to allow the banks, their officers and their credit committees to assess the risk in continuing to lend money to Avista Corp.

Q. Does the Company's request for interim rate relief satisfy the Commission's standards for interim rate relief?

A. Yes, it does. The commission articulated standards for interim relate relief in <u>WUTC v. Pacific Northwest Bell Telephone Co.,</u> Cause No. U-72-30, Second Supplemental Order Denying Petition for Emergency Rate Relief (October 1972) (hereinafter "Pacific Northwest Bell" or "PNB"), as follows:

> (1) The Commission has authority under proper circumstances to grant interim rate relief to a utility, but this should be done only after an opportunity for adequate hearing.

(2) An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity.

(3) The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify the granting of interim relief.

(4) The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage and the growth, stability or deterioration of each, together with the immediate and short term demands for new financing and whether the grant or failure to grant interim relief will have such an effect on the financing demands as to substantially affect the public interest.

(5) In the current economic climate, the financial health of a utility may decline very swiftly and interim relief stands as a useful tool in an appropriate case to stay off impending disaster. However, this tool must be used with caution and applied only in a case where not to grant would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders. That is not to say that interim relief should be granted only after disaster has struck or is imminent, but neither should it be granted in any case where full hearings can be had and the general case resolved without clear detriment to the utility.

(6) Finally, as in all matters, we mush reach our conclusions with the statutory charge to the Commission in mind, that is to "regulate in the public interest" (RCW 80.01.040). This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.

I will explain how Avista meets each standard with this request for interim relief.

Q. How has the first standard enunciated in the PNB case been satisfied?

A. The first standard is quite straightforward:

(1) The Commission has authority under proper circumstances to grant interim rate relief to a utility, but this should be done only after an opportunity for adequate hearing.

The Company has filed a full set of testimony and exhibits on December 3, 2001, to demonstrate and support the need for rate relief, including interim relief, of which my testimony is an integral part. We are requesting a procedural schedule, including hearings, that would have the Commission reach a decision on the interim rate relief request by mid-March 2002, leaving over three and one-half months to conduct the process for review and the provide for adequate hearings. In addition, the Company is proposing the interim rate relief be granted on a "subject to refund" basis; therefore, during the remaining hearings on the general rate request, the basis for the interim increase can be thoroughly reviewed, with the possibility for a refund as an option. The Company stands ready to address all relevant questions in hearings in an expedited manner.

There will be an opportunity for all parties to submit testimony, to conduct cross examination, and to present their positions prior to a mid-March 2002 decision on interim relief by the Commission.

Q. Does the Company's present situation satisfy the emergency nature of the Commission's second interim relief standard?

A. Yes, it does. The Commission's second standard for interim relief states:

> (2) An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity.

As explained earlier, the Company's credit rating has been set below investment grade by both Moody's and Standard & Poor's. In order to maintain availability of borrowing capacity under the bank line of credit, the Company was forced to obtain a waiver of default for certain covenants in that credit agreement.

The Company has reduced costs, to a level that capital budgets for the latter part of 2001 and for 2002 are below sustainable levels, in an extraordinary effort to preserve cash under the present liquidity constraints. The Company has also sold certain assets in an effort to raise cash and reduce future cash outflows. These are examples of management's response to "prevent gross hardship" from becoming irreversible.

It has become clear that it will be difficult to obtain renewal of the Company's short-term bank line of credit and the accounts receivable financing. The short-term financing facilities expire on May 29, 2002 and the Company will need to have access to funds through and beyond that date for normal operations. The negotiations related to these facilities will begin in earnest in March of 2002, and resolution of this interim rate issue is important to the process. To help assure that these facilities can be renewed as needed and that other needed financing can be obtained in the upcoming year, the Company needs a timely and favorable Commission decision in the prudence filing (Docket No. UE-011514) and a timely decision allowing interim relief as requested in the present filing. Thus, an interim rate increase should be granted to "prevent gross hardship or gross inequity" from being suffered by the Company and ultimately by its customers. Without interim relief, Avista could be prevented from securing the capital necessary to meet its public service obligations and a gross hardship could be a result.

Q. What is the Commission's third standard for interim relief?

A. Again from the PNB case, the third standard addresses failure to meet an approved rate of return:

> (3) The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify the granting of interim relief.

Q. Is Avista seeking interim rate relief simply to boost its rate of return to the level last approved by the Commission?

A. No, the amount of interim rate relief that Avista is requesting is well below the amount needed to satisfy the revenue requirement that would support earning the rate of return last authorized by this Commission. Even with all of the requested relief, the Company's return on equity in 2002 would be only 9.0%. As Mr. Ely explains in his testimony, the Company is requesting interim relief in an amount of 12.4%, while we have shown that an increase of 22.5% in base rates is otherwise needed to provide a full opportunity to earn an adequate rate of return. The Company purposely reduced the size of the interim rate increase to reduce the rate shock experienced by customers.

The interim increase does not restore the rate of return to the level allowed in the Company's last general rate case, nor does it meet the rate of return supported in the present case. The Company's application for interim rate relief is not predicated solely on the basis of an inadequate rate of return; instead, interim rate relief is necessary for the Company to address its financial needs, restore positive cash flows, preserve its current credit and its access to capital markets under reasonable terms, cover day-to-day operating costs, and to obtain financing. The Company's motivation for interim rate relief is not to create any specific rate of return; rather, our intent is to improve cash flows to reduce the need for borrowing, and to demonstrate to the financial community that a financial turn-around is indeed in progress during the critical phase of renewing financing arrangements for short-term credit.

Q. Will the requested rate relief affect Avista's financial indicators and its ability to obtain financing on reasonable terms?

A. Yes. This standard states:

> (4) The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage and the growth, stability or deterioration of each, together with the immediate and short term

> demands for new financing and whether the grant or failure to grant interim relief will have such an effect on the financing demands as to substantially affect the public interest.

This standard essentially requires a review of the financial indicators that reflect on the Company's financial condition and its ability to obtain financing. There are several financial indices in the fourth interim relief standard from the PNB case that will be impacted. I will review these. The standard also requires a review to determine if there is a near term need for financing. This need is discussed in detail by Mr. Eliassen.

Q. With regard to this standard, what impact will interim rate relief have on Avista's rate of return?

A. The Company's rate of return without continued deferrals and absent interim rate relief is shown in comparison to the pro forma rate of return with the requested relief in Exhibit __ (RRP-1), pages 1 and 2. The return on equity for 2002 without any rate increases or deferrals is projected to be 2.3%. If all of the Company's requests, including the extension of deferrals, are approved as proposed, the return on equity in 2002 is projected to be 9.0%. This is well below the 11.16% return on equity authorized in the last general case.

Q. How would Avista's interest coverage be affected by the requested rate relief?

A. Without the requested relief, Avista's pre-tax interest coverage ratio will continue to deteriorate and will be substantially below that required for an investment grade credit rating. With relief, pre-tax interest coverage for 2002 would be improved from 1.30x to 1.81x as shown on line 6, pages 1 and 2 of Exhibit __ (RRP-1). The interest coverage ratio would improve to 2.11x by the end of 2003. Note that even with the requested rate relief, interest coverage remains below the minimum standard of 2.40x for an investment grade credit rating. However, the trend of improving interest coverage will be viewed as a positive development by banks and rating agencies and thus provide some comfort to banks as we renew our credit facilities in early 2002. In the longer term, interest coverage is expected to show additional improvement through the reduction of overall debt by made possible by positive cash flows from operations, including recovery of deferred power costs that the Company is carrying on its balance sheet. Interim rate relief provides a much-needed stabilizing effect on the interest coverage ratio that has been steadily deteriorating to unacceptably weak levels over the last year.

Q. To what extent are Company earnings covering operating cash requirements, and how will interim rate relief affect earnings coverage?

A. Avista's cash requirements for operations include the expenditures for power that are deferred. Deferred costs consume cash although the reported earnings are not correspondingly reduced. Avista filed for recovery of deferred power costs earlier in 2001 in Docket No. UE-010395. The 25% temporary power cost surcharge ordered by the Commission helps to partially recover previously deferred costs, but only those incurred up until September 30, 2001. Through the end of 2001, Avista is continuing to consume more cash in operations than it is bringing in through revenues. An interim rate increase will improve cash flows from earnings to cover necessary expenses of operations, capital requirements and refinancing debt maturities. As I discussed earlier, these needs exceed operating cash flows by nearly $50 million for the forth quarter of 2001 and first two quarters of 2002. Detail of these cash requirements is shown on Mr. Eliassen's Exhibit No.__(JEE-5).

Q. How will approval of interim rate relief affect Avista's immediate and short-term demands for financing?

A. The interim relief requested will increase the cash from operations by over $17 million in 2002. This will provide a significant additional source of cash to the Company and renewal of the short-term bank facility and accounts receivable facility will be aided by the additional cash flow, earnings improvement, and signal of continued regulatory support to address Avista's financial situation. Failure to grant the necessary interim rate relief would result in significant difficulty when renewing these financing sources and could adversely affect the public interest.

Q. Why is interim relief needed when the Company's general rate request is in process and is expected to reach the point of a final decision in October of 2002?

A. The Company simply cannot wait until the fourth quarter of 2002 for positive actions and improvements in cash flows, especially when considering that the Company will be renegotiating its credit lines in the first quarter. The need for financing is more immediate than the fourth quarter of 2002. Cash flow problems have been compounded by the extent of unrecovered power costs that remain deferred on the Company's balance sheet.

Q. Has the Company demonstrated that the fifth standard has been met?

A. Yes. The Company has clearly shown that the Commission's fifth PNB standard for interim rate relief has been satisfied.

> (5) In the current economic climate, the financial health of a utility may decline very swiftly and interim relief stands as a useful tool in an appropriate case to stay off impending disaster. However, this tool must be used with caution and applied only in a case where not to grant would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders. That is not to say that interim relief should it be granted only after disaster has struck or is imminent, but neither should it be granted in any case where full hearings can be had and the general case resolved without clear detriment to the utility.

The Commission has recognized that interim rate relief should not be reserved <u>only</u> for those situations "after disaster has struck or is imminent"; rather, it is an appropriate remedy where one can reasonably anticipate serious consequences. The credit warnings of Moody's and Standard & Poor's sound a clear warning concerning Avista's financial situation and the consequences of failure to obtain needed rate relief. The Company has already been downgraded to below investment grade and the outlook on Avista from rating agencies is negative. Neither the Company nor its customers will benefit from the speculative-grade credit ratings that have now been assigned to Avista, either in terms of the Company's access to necessary capital or the cost thereof. The peril to the utility and its customers, absent interim rate relief, should be apparent. Further downgrades are not acceptable and reasonable access to capital on reasonable terms to fund necessary activities to meet customer needs is at stake.

Q. Does the Company's filing comply with the sixth standard?

A. The sixth standard states as follows:

> (6) Finally, as in all matters, we must reach our conclusions with the statutory charge to the Commission in mind, that is to "regulate in the public interest" (RCW 80.01.040). This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.

The Company has already experienced significant cost increases and difficulty in accessing capital on reasonable terms as a direct result of its current financial condition. Continuation of these types of cost increases is not in the public interest. The step-by-step process of restoring Avista's financial health is clearly in the public interest. Interim rate relief is an important step in this restoration process. The Company's request for a power cost surcharge was an important step, one that was only partially approved. The prudency determination requested by the Company is another important step. In this proceeding, Avista has proposed relief in the form of a temporary extension of power cost deferrals, and implementation of interim and general rate increases that will move the Company back towards an investment grade rating. This is clearly in the public interest in the long run as it will ultimately lead to lower costs to customers and a healthier and more stable company.

In this proceeding, Avista asks that "reasoned judgment" take into consideration the "salient factors": Avista has incurred substantial costs in the discharge of its public service obligations, bringing financial pressures to bear that require immediate rate relief. The Company needs to cover its ongoing operating and capital costs; needs to be able to refinance and fund maturing debt; needs to cover the costs of carrying substantial deferred power balances; needs to satisfy its bank covenants and renew its expiring credit facilities; needs to sell common stock; and needs to restore its credit ratings to investment grade. These factors all argue strongly for interim rate relief.

Q. Please explain the covenants that Avista must comply with under its line of credit with banks.

A. The covenants under our credit facility are shown in Exhibit __ (RRP-1), pages 3 and 4. The key covenants are a times interest coverage test and a maximum debt ratio. As can be seen, without rate relief, the Company will not be able to meet many of the existing covenants until the later part of 2002. With the interim relief requested by the Company, all covenants under the credit facility would be met starting in March of 2002.

Q. What are the impacts of various covenants in the Company's existing securities and credit facilities?

A. Avista's committed line of credit contains covenants requiring the Company to maintain specified financial ratios. The Company met the consolidated total debt to total capitalization ratio minimally for the period ended September 30, 2001. A maximum debt ratio of 60% is allowed while the Company achieved a ratio of 59.3%. The line of credit also has a minimum fixed charge (interest) coverage ratio. Because of the significant amount of cash expended on power cost deferrals, the Company was not able to meet this covenant and absent interim relief, does not expect to meet this covenant for the utility until at least September of 2002. On September 10, 2001 the Company executed a waiver for the fixed charge coverage ratio for the term of the credit agreement which expires May 29, 2002. As a condition of the waiver, the Company secured the committed line of credit with first mortgage bonds and was required to pay significant fees.

On April 3, 2001, the Company issued $400 million of 9.75% Senior Notes due June 1, 2008. These notes are issued under an indenture that restricts the ability of the Company to engage in certain activities under certain credit rating conditions. However, if a rating by Moody's and Standard and Poor's on senior unsecured debt is at least Baa2 and BBB, respectively, with a stable or improving outlook, selected covenants will be suspended. The Company's current credit rating makes all of the restrictions applicable. Unless the above stated rating condition is satisfied, the Company is restricted from repaying subordinated debt. The Company is also restricted on the amount of debt and preferred stock that can be issued until the rating condition is satisfied or until a fixed charge coverage ratio of 2.0 to 1.0 on a pro forma basis is achieved. The Company's current projections indicate that the fixed charge coverage ratio test will not be met until at least September 2002. The notes also contain various restrictions related to the proceeds from asset sales and sale/leaseback transactions. Proceeds from these transactions must be used to repay indebtedness, to make capital expenditures, or to acquire long-term assets within a certain period of time until the rating condition is satisfied.

In addition, there are covenants in various other agreements that result in an event of default, or increased costs if the Company's credit rating falls below investment grade. The most significant other agreements affected are: the accounts receivable financing, certain series of medium term notes and the Avista Energy credit agreement. Curing these defaults has been expensive and time consuming. The impact on these is discussed in more detail by Mr. Eliassen.

The Need for and Benefits of a Power Cost Adjustment (PCA) Mechanism

Q. Please provide a brief overview of the Company's request for a Power Cost Adjustment mechanism, or PCA.

A. In this filing, the Company is requesting that the Commission authorize a power cost adjustment mechanism. Implementation of such a mechanism, as proposed by the Company, would clearly provide benefits to both the Company's customers and its shareholders. The PCA would add stability to the various financial indices that rating agencies and other members of the financial community use to assess the financial health and risk associated with the Company. The ability of the Company to more consistently meet interest coverage ratios and other financial benchmarks would reduce the perceived risk by lenders and investors. This added financial stability would not only improve access to capital, but will also allow the Company to obtain financing at more reasonable terms. Because the utility business is a capital-intensive industry, the cost of financing is a major component of the overall cost to provide service to customers, and the benefits to customers of access to capital on reasonable terms can be significant.

In this filing the Company has proposed a reduction in the requested return on equity of 50 basis points associated with the proposed implementation of the PCA, which would be an immediate direct benefit to customers. In addition, the added financial stability would result in lower debt interest costs to the Company over time, which would ultimately result in lower rates to customers than they would otherwise be. With regard to shareholders, the added financial stability would help to attract equity investors and improve the value of the Company's stock. An improved stock value would, in turn, improve the opportunity to issue equity as needed to meet capital requirements.

Thus, implementation of the proposed PCA would provide benefits to customers, as well as provide a healthier utility for customers, shareholders, and the communities in which the Company operates.

Q. Why is a PCA or similar mechanism critical for Avista?

A. A PCA is more important today than it ever has been in the past. The Company has exposure to significant variability in the costs of power to serve its customers. Due to its reliance on hydroelectric generation, the amount of energy the Company has available from owned resources can vary substantially from month to month and year to year. In the past, this has not been as significant because power was generally available for purchase at reasonable and fairly stable and predictable prices. In fact, the Company's hydroelectric resources have allowed it to be one of the lowest cost producers and sellers of electric energy in the country. However, power markets have undergone major changes in the past two years and prices for purchased power are much more volatile than in the past. If the Company is in a position where it must buy power, the financial impacts can be very significant for the Company and ultimately its customers. The Company has already been hit with the financial consequences of this fundamental change. Mr. Norwood explains in his testimony the variability of hydro conditions and the potential financial impact of that variability.

The concern over this exposure to cost volatility is readily apparent in the recent credit rating downgrades for Avista and the continued negative outlook that the rating agencies have regarding Avista. Volatility and questions about cost recovery create uncertainties that are a major concern to investors trying to determine a company's ability to pay interest and repay debt. If the uncertainty is large enough, an investor will require a substantial risk premium before making an investment. An effective PCA will help to offset the financial impacts and would ultimately contribute to a significant improvement in the Company's financial health.

Q. Why is a PCA better than deferrals or "side account" approaches?

A. Uncertainty of cost recovery is a major issue for the Company. Uncertainly means more risk to an investor. The added risk results in higher costs of capital for the Company and ultimately results in higher rates for customers. Of these approaches, a PCA has the lowest amount of uncertainty associated with it. A PCA is seen as a long-term solution, not a short-term fix as the other approaches are viewed. Over the long term, a PCA will help to reduce cash flow variability and volatility and will provide more certainty of interest coverage ratios and cash flows available for debt service. This is turn will result in lower risk premiums for investors in the Company's securities.

Q. Now that power prices have returned to more normal levels, is a PCA really needed?

A. A PCA is a long-term solution required to address uncertainty around recovery of costs of power incurred to serve customers. There has been a fundamental change in power markets that will impact the Company. Although prices for power are lower than they have been recently, they are still high by historical standards. In addition, there is no certainty about what prices will be over the longer term or the next time the Company will need to purchase a significant amount of power. The California market issues are still unresolved and FERC price mitigation is currently scheduled to end in the third quarter of 2002. A PCA implemented now will go a long way to resolving the uncertainty to Avista because of what may happen in the market and will be a key step to improving the Company's financial health.

Q. How do rating agencies view a PCA?

A. Rating agencies generally view a PCA as a positive when rating a company's credit standing. In Moody's October 8, 2001 release related to Avista, they stated specifically that a PCA would help to stabilize the Company's credit rating outlook:

> " ... a favorable outcome of the general rate filing to be made by December 1, 2001 would help stabilize the current negative rating outlook. This would be especially so if the outcome implements a power cost adjustment mechanism to create more certainty surrounding recovery of Avista's power supply costs incurred to serve its customers in the Washington jurisdiction."

Q. Does an Idaho style PCA meet the Company's needs?

A. Yes. In a December 29, 2000 report on Avista Corp., Standard & Poor's commented specifically on the Idaho PCA in effect for Avista. They stated:

> " In Idaho, the regulatory environment is better than average, because it provides Avista with a PCA for regulated electric operations, as well as purchased gas adjustment (PGA)."

It is apparent that if a PCA were adopted in the Washington jurisdiction that was similar to the PCA Avista currently has in place in Idaho, it would be viewed favorably by the financial community.

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

A. Yes, it does.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-01_______

EXHIBIT NO. ____ (RRP-1)

WITNESS: RONALD R. PETERSON, AVISTA CORP.

Avista Corp
Financial Indicators
1999-2003
With No Rate Increases

Line No.		1999	2000	Year-end Projections - With NO Rate Increases in 2002 and NO New Financings 2001	2002	2003	Investment Grade Criteria* A	BBB	Non-Investment Grade BB	B
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
	Internal Funds From Operations:									
1	Interest Coverage	2.5x	2.7x	0.7x	2.4x	1.7x	4.0 - 4.8	3.0 - 4.0x	**2.1 - 3.0x**	$\boxed{1.1 - 2.1x}$
	Internal Funds from Operations:									
2	As a % of Debt	16.6%	19.6%	6.2%	24.5%	17.2%	27 - 33%	**20.5 - 27%**	$\boxed{15 - 20.5\%}$	7.5 - 15%
	Capitalization Ratios:									
3	Debt	54.0%	51.9%	58.4%	56.6%	56.9%	41.5 - 47%	47 - 55%	$\boxed{\mathbf{55 - 62.5\%}}$	62.5 - 71%
4	Preferred Stock	23.4	7.6	6.5	6.6	6.6				
5	Common Equity	22.6	40.5	35.1	36.8	36.5				
	Pretax Interest Coverages:									
6	Including AFUDC and AFUCE	1.97x	2.29x	1.52x	1.30x	1.19x	3.5 - 4.3x	2.4 - 3.5x	1.5 - 2.4x	$\boxed{\mathbf{0.6 - 1.5x}}$
7	Excluding AFUDC and AFUCE	1.93x	2.26x	1.48x	1.29x	1.17x				
8	Utility Net Income for Common	$38,181	($62,516)	$36,966	$8,906	$5,580				
9	Utility Earnings per Share	$1.00	($1.37)	$0.78	$0.34	$0.01				
10	Utility Return on Equity	12.5%	-10.4%	9.9%	2.3%	0.2%				

**Benchmarks from Standard & Poor's for Business Position "5" (Avista's current Business Position).*

Boxed area represents where Avista would be by the end of 2003

Bold underlined area represents where Avista would be by the end of 2002. Note that two of the financial indicators would be in the same category as 2003.

Projections based on internal forecast prepared November 28, 2001.

Avista Corp
Financial Indicators
1999-2003
With Rate Increases

Line No.		1999	2000	2001	2002	2003	A	BBB	BB	B
				Year-end Projections - Includes Rate Increases in 2002 and New Financings			Investment Grade Criteria*		Non-Investment Grade	
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
	Internal Funds From Operations:									
1	Interest Coverage	2.5x	2.7x	0.7x	2.6x	2.5x	4.0 - 4.8	3.0 - 4.0x	**2.1 - 3.0x**	1.1 - 2.1x
	Internal Funds from Operations:									
2	As a % of Debt	16.6%	19.6%	5.9%	27.7%	26.5%	**27 - 33%**	20.5 - 27%	15 - 20.5%	7.5 - 15%
	Capitalization Ratios:									
3	Debt	54.0%	51.9%	59.4%	52.5%	48.4%	41.5 - 47%	**47 - 55%**	55 - 62.5%	62.5 - 71%
4	Preferred Stock	23.4	7.6	6.3	6.6	6.9				
5	Common Equity	22.6	40.5	34.3	40.9	44.7				
	Pretax Interest Coverages:									
6	Including AFUDC and AFUCE	1.97x	2.29x	1.52x	1.81x	2.11x	3.5 - 4.3x	2.4 - 3.5x	**1.5 - 2.4x**	0.6 - 1.5x
7	Excluding AFUDC and AFUCE	1.93x	2.26x	1.48x	1.80x	2.09x				
8	Utility Net Income for Common	$38,181	($62,516)	$36,902	$42,044	$51,856				
9	Utility Earnings per Share	$1.00	($1.37)	$0.78	$0.88	$1.03				
10	Utility Return on Equity	12.5%	-10.4%	9.9%	9.0%	9.2%				

**Benchmarks from Standard & Poor's for Business Position "5" (Avista's current Business Position).*

Boxed area represents where Avista would be by the end of 2003

Bold underlined area represents where Avista would be by the end of 2002. Note that three of the financial indicators would be in the same category as 2003, even though the 2003 indicators are generally stronger.

Projections based on internal forecast prepared November 29, 2001.

Avista Corp.
Projected Bank Covenants
With NO Rate Increases

Estimated Fixed Charge Coverage Ratio

Period	Required Ratio*	Calculated Ratio	Covenant Status
Consolidated			
Dec 2001	1.00	**-1.32**	**NOT MET**
Mar 2002	1.50	**0.74**	**NOT MET**
June 2002	2.00	**0.88**	**NOT MET**
Sept 2002	2.00	**1.83**	**NOT MET**
Dec 2002	2.00	**1.80**	**NOT MET**
Mar 2003	2.00	**1.85**	**NOT MET**
June 2003	2.00	**1.16**	**NOT MET**
Sept 2003	2.00	**0.96**	**NOT MET**
Dec 2003	2.00	**0.35**	**NOT MET**
Utility Only			
Dec 2001	1.25	**-0.80**	**NOT MET**
Mar 2002	1.50	**1.28**	**NOT MET**
June 2002	2.00	**1.22**	**NOT MET**
Sept 2002	2.00	2.10	COMPLY
Dec 2002	2.00	2.01	COMPLY
Mar 2003	2.00	2.06	COMPLY
June 2003	2.00	**1.37**	**NOT MET**
Sept 2003	2.00	**1.17**	**NOT MET**
Dec 2003	2.00	**0.57**	**NOT MET**

Estimated Total Debt to Total Capitalization Ratio

Period	Required Ratio*	Calculated Ratio	Covenant Status
Dec 2001	60.00	58.87	COMPLY
Mar 2002	60.00	56.93	COMPLY
June 2002	60.00	56.98	COMPLY
Sept 2002	60.00	56.64	COMPLY
Dec 2002	60.00	56.61	COMPLY
Mar 2003	60.00	55.11	COMPLY
June 2003	60.00	55.92	COMPLY
Sept 2003	60.00	56.30	COMPLY
Dec 2003	60.00	56.93	COMPLY

* Required ratios after May 2002 are estimates as the Credit Agreement currently in place expires May 29, 20(

Projections based on internal forecast prepared November 28, 2001.

Avista Corp
Projected Bank Covenents
With Rate Increases

Estimated Fixed Charge Coverage Ratio

Period	Required Ratio*	Calculated Ratio	Covenant Status
Consolidated			
Dec 2001	1.00	**0.22**	**NOT MET**
Mar 2002	1.50	2.46	COMPLY
June 2002	2.00	2.46	COMPLY
Sept 2002	2.00	3.18	COMPLY
Dec 2002	2.00	4.42	COMPLY
Mar 2003	2.00	4.28	COMPLY
June 2003	2.00	3.90	COMPLY
Sept 2003	2.00	**1.91**	**NOT MET**
Dec 2003	2.00	**1.50**	**NOT MET**
Utility Only			
Dec 2001	1.25	**0.71**	**NOT MET**
Mar 2002	1.50	2.94	COMPLY
June 2002	2.00	2.74	COMPLY
Sept 2002	2.00	3.31	COMPLY
Dec 2002	2.00	4.49	COMPLY
Mar 2003	2.00	4.35	COMPLY
June 2003	2.00	3.96	COMPLY
Sept 2003	2.00	**1.99**	**NOT MET**
Dec 2003	2.00	**1.58**	**NOT MET**

Estimated Total Debt to Total Capitalization Ratio

Period	Required Ratio*	Calculated Ratio	Covenant Status
Dec 2001	60.00	59.82	COMPLY
Mar 2002	60.00	57.05	COMPLY
June 2002	60.00	56.21	COMPLY
Sept 2002	60.00	54.53	COMPLY
Dec 2002	60.00	52.50	COMPLY
Mar 2003	60.00	50.91	COMPLY
June 2003	60.00	50.34	COMPLY
Sept 2003	60.00	48.41	COMPLY
Dec 2003	60.00	48.45	COMPLY

* Required ratios after May 2002 are estimates as the Credit Agreement currently in place expires May 29, 200:

Projections based on internal forecast prepared November 29, 2001.