Exh. MTT-1T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-22____

DOCKET NO. UG-22____

DIRECT TESTIMONY OF

MARK T. THIES

REPRESENTING AVISTA CORPORATION

1 **I. INTRODUCTION**

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

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

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

8 A. I received a Bachelor of Arts degree in 1986 with majors in Accounting and
9 Business Administration from Saint Ambrose College in Davenport, Iowa, and became a
10 Certified Public Accountant in 1987. I have extensive experience in finance, risk management,
11 accounting and administration within the utility sector.

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

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

20 A. I will provide a financial overview of Avista Corporation as well as explain
21 our credit ratings and the Company's proposed capital structure and overall rate of return in
22 this case. Company witness Mr. McKenzie will provide additional testimony related to the
23 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 plans call for a continuation of utility capital investments in generation, transmission, electric and natural gas distribution systems and technology to preserve and enhance service reliability for our customers, including the continued replacement of aging infrastructure. Capital expenditures of $445 million per year (system) are planned for the five-year period ending December 31, 2026. Avista needs adequate cash flow from operations to fund these requirements, together with access to capital from external sources under reasonable terms, on a sustainable basis.

2. We are proposing an overall rate of return of 7.31 percent, which includes a 48.5 percent common equity ratio, a 10.25 percent return on equity, and a cost of debt of 4.54 percent. We believe our proposed overall rate of return of 7.31 percent and the proposed capital structure provide a reasonable balance between safety and economy.

3. Avista's corporate credit rating from Standard & Poor's (S&P) is currently BBB and Baa2 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.

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

2 A. Yes. I am sponsoring Exh. MTT-2, pages 1 through 8, which was prepared
3 under my direction. Avista's credit ratings by S&P and Moody's are summarized on page 1.
4 Avista's proposed capital structure and cost of capital are included on page 2, with supporting
5 information on pages 3 through 8. Confidential Exh. MTT-3C is the Company's Interest Rate
6 Risk Management Plan. Finally, Confidential Exh. MTT-4C shows the Company's planned
7 capital expenditures and long-term debt issuances by year for 2022-2025.

8

9 **II. FINANCIAL OVERVIEW**

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

11 A. Avista has and will continue to operate the business efficiently to keep costs as
12 low as practicable for our customers, while at the same time ensuring that our energy service
13 is reliable, and our customers are satisfied. An efficient, well-run business is not only
14 important to our customers but also important to investors. Our capital financing plan, and
15 our execution of that plan, provides a prudent capital structure and liquidity necessary for
16 utility operations. We initiate regulatory processes to recover our costs in a timely manner
17 with the goal of achieving earned returns close to those allowed by regulators in each of the
18 states we serve. These elements – cost management, and ready access to capital and revenues
19 that support operations – are key determinants to the rating agencies when they are reviewing
20 our overall credit ratings.

21 **Q. What steps are being taken by Avista to maintain and improve its financial**
22 **health?**

23 A. We are working to assure there are adequate funds for operations, capital

1 expenditures and debt maturities. We obtain a portion of these funds through the issuance of
2 long-term debt and common equity. We actively manage risks related to the issuance of long-
3 term debt through our interest rate risk mitigation plan and we maintain a proper balance of
4 debt and common equity through regular issuances and other transactions. We actively
5 manage energy resource risks and other financial uncertainties inherent in supplying reliable
6 energy services to our customers. We create financial plans and forecasts to model our
7 income, expenses and investments, providing a basis for prudent financial planning. We seek
8 timely recovery of our costs through general rate cases and other ratemaking mechanisms.
9 The Company currently has a sound financial profile and it is very important for Avista to
10 maintain and enhance its financial position in order to access debt and equity financing under
11 reasonable terms as Avista funds significant future capital investments and refinances
12 maturing debt.
13
14 **III. CAPITAL EXPENDITURES**

15 **Q. What is the Company's recent history related to capital investments?**

16 A. Avista is making significant capital investments in our natural gas distribution
17 system, electric generation, transmission and distribution facilities, and new technology to
18 better serve the needs of our customers. These investments are focused on, among other things,
19 the preservation and enhancement of safety, service reliability and the replacement of aging
20 infrastructure. For the period 2017 through 2021, our capital expenditures averaged
21 approximately $425 million per year, on a system basis (i.e., Washington, Idaho, and Oregon,
22 electricity and natural gas).

23 Avista's plans continue to call for making significant utility capital investments in our

1 electric and natural gas systems to preserve and enhance service reliability for our customers,
2 including the continued replacement of aging infrastructure. Capital expenditures of
3 approximately $445 million per year, on a system basis, are planned for the five-year period
4 ending December 31, 2026. Avista needs adequate cash flow from operations to fund these
5 requirements, together with access to capital from external sources under reasonable terms, on
6 a sustainable basis.

7 **Q. What does Avista consider in setting the overall level of capital investment**
8 **each year?**

9 A. A range of factors influences the level of capital investment made each year,
10 including: 1) the level of investment needed to meet safety, service and reliability objectives
11 and to further optimize our facilities; 2) the degree of overall rate pressure faced by our
12 customers; 3) the variability of investments required for major projects; 4) unanticipated
13 capital requirements, such as an unplanned outage on a large generating unit; 5) the cost of
14 debt; and 6) the opportunity to issue equity on reasonable terms.

15 **Q. In previous rate cases you provided testimony related to capital budgeting**
16 **and prioritization. Are you providing similar testimony in this proceeding?**

17 A. I am not. Rather, Company witness Mr. Ehrbar is providing more detailed
18 testimony on capital budgeting and prioritization in his testimony, Exh. PDE-1T.

19

20 **<u>IV. MATURING DEBT</u>**

21 **Q. How is Avista affected by maturing debt obligations in the next five years?**

22 A. In the next five years, the Company is obligated to repay maturing long-term
23 debt totaling $263.5 million as shown in Table No. 1 below. Within this forward-looking

1 five-year period, a large concentration – $250 million – matures within the second quarter of
2 2022.

3 **Table No. 1 – Long-Term Debt Maturities**

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Avista Corp Long-Term Debt Maturities, 2022-2025				
Maturity Year	*Principal Amount*	*Coupon Rate*	*Date Issued*	*Maturity Date*
2022	$ 250,000,000	5.125%	9/22/2009	4/1/2022
2023	$ 5,500,000	7.530%	5/6/1993	5/5/2023
	$ 1,000,000	7.540%	5/7/1993	5/5/2023
	$ 7,000,000	7.180%	8/12/1993	8/11/2023
2024	-	-	-	-
2025	-	-	-	-
Total	*$ 263,500,000*			

10 These debt obligations originated as early as 1993 and their original terms were
11 between 10 and 20 years. These maturing obligations represent 13 percent of the Company's
12 long-term debt outstanding at the end of 2021, which is a significant portion of our capital
13 structure. It will be necessary for Avista to be in a favorable financial position to complete
14 the expected debt refunding under reasonable terms, while also obtaining debt and equity to
15 fund capital expenditures each year.

16 **Q. What are the Company's expected long-term debt issuances through**
17 **2025?**

18 A. To provide adequate funding for the significant capital expenditures noted in
19 Section III above and to repay maturing long-term debt, we are forecasting the issuance of
20 long-term debt in each year through 2025. We issued $140 million in 2021. Issuances planned
21 for 2022 through 2025 are provided in Confidential Exh. MTT-4C.

22 **Q. Has Avista considered recalling of debt to take advantage of current low**
23 **long-term interest rates?**

1 A. Yes. However, the recall provisions of debt issued require penalties (make-
2 whole provisions) that exceed the value gained from current market interest rates. As
3 discussed later in my testimony, Avista has an Interest Rate Risk Management Plan for
4 issuance of long-term debt that includes hedging a portion of future issuance through interest
5 rate swaps.

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

7 A. Yes. In addition to long-term debt, the Company's $400 million revolving
8 credit facility expires in June of 2026. The Company relies on this credit facility to provide,
9 among other things, funding to cover month-to-month variations in cash flows, interim
10 funding for capital expenditures, and credit support in the form of cash and letters of credit
11 that are required for energy resources commitments and other contractual obligations. A
12 strong financial position will be necessary to gain access to a new or renewed revolving credit
13 facility, under reasonable terms, prior to expiration of the existing facility.

14

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

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

18 A. Our proposed capital structure is 51.5 percent debt and 48.5 percent equity,
19 with a proposed cost of debt of 4.54 percent, a proposed 10.25 percent return on equity (ROE),
20 and a requested overall rate of return (ROR) in this proceeding of 7.31 percent, as shown in
21 Table No. 2 below.[1]

[1] 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 $150 million of short-term debt.

1 **Table No. 2 – Proposed Cost of Capital**

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AVISTA CORPORATION Proposed Cost of Capital December 31, 2023				
		Proposed Structure	Component Cost	Weighted Cost
Total Debt		51.5%	4.54%	2.34%
Common Equity		48.5%	10.25%	4.97%
	Total	100.0%		7.31%

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7 **Q. Why is the Company proposing a 48.5 percent equity ratio?**

8 A. On September 30, 2021, Avista's common equity percentage for the
9 Washington jurisdiction was 49%. The Company continues to evaluate the extent and timing
10 of equity issuances for 2022, considering our capital expenditures and other financial
11 requirements. These steps to manage our equity level are expected to result in an average
12 common equity level of approximately 48.5% for 2022 and 2023.

13 Maintaining a 48.5 percent common equity ratio has several benefits for customers.
14 We are dependent on raising funds in capital markets throughout all business cycles. These
15 cycles include times of contraction and expansion. A solid financial profile will assist us in
16 accessing debt capital markets on reasonable terms in both favorable financial markets and
17 when there are disruptions in the financial markets.

18 Additionally, a 48.5 percent common equity ratio solidifies our current credit ratings
19 and moves us closer to our long-term goal of having a corporate credit rating of BBB+. A
20 rating of BBB+ would be consistent with the natural gas and electric industry average, which
21 I will further explain later in my testimony. We rely on credit ratings in order to access capital
22 markets on reasonable terms. Moving further away from non-investment grade (BB+)
23 provides more stability for the Company, which is also beneficial for customers. We believe

1 our requested 48.5 percent equity appropriately balances safety and economy for customers.

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

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

9 Both Moody's and S&P cite the regulatory environment in which a regulated utility
10 operates as the dominant qualitative factor to determine a company's creditworthiness.
11 Moody's rating methodology is based on four primary factors. Two of those factors – a
12 utility's "regulatory framework" and its "ability to recover costs and earn returns" – make up
13 50 percent of Moody's rating methodology[2]. In addition, S&P stated[3]:

14 Regulation is the most critical aspect that underlies regulated integrated
15 utilities' creditworthiness. Regulatory decisions can profoundly affect
16 financial performance. Our assessment of the regulatory environments in
17 which a utility operates is guided by certain principles, most prominently
18 consistency and predictability, as well as efficiency and timeliness. For a
19 regulatory process to be considered supportive of credit quality, it must limit
20 uncertainty in the recovery of a utility's investment. They must also eliminate,
21 or at least greatly reduce, the issue of rate-case lag, especially when a utility
22 engages in a sizable capital expenditure program.
23
24 **Q. How have the rating agencies viewed recent legislation in Washington that**
25 **could provide for more constructive regulatory outcomes?**

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[2] Moody's Investors Service, Rating Methodology: Regulated Electric and Gas Utilities, June 23, 2017.
[3] Standard and Poor's, Key Credit Factors: Business and Financial Risks in the Investor-owned Utility Industry, March 2010.

1 A. Moody's states the following[4]:

2 The recently passed SB 5295 (enacted on 3 May 2021) followed the clean
3 energy bill and aims at reforming the regulatory framework for utilities in the
4 state by paving the way for multiyear rate plans (MYRP) and performance-
5 based ratemaking (PBR). We view the bill as credit positive as it could enhance
6 the consistency and predictability of utility regulation. Specifically, we view
7 the PBR construct as a credit supportive rate making mechanism because
8 MYRPs with performance targets and the potential to earn performance
9 incentives will work to reduce regulatory lag. It could also aid Avista's
10 renewable transition, improve operational efficiency and enhance cash flow
11 and profitability, all while considering customer cost and service.
12 Nevertheless, the extent to which the new law will enhance the Washington
13 regulatory framework and improve utility financial performance is subject to
14 WUTC decisions, which have been historically inconsistent.
15

16 S&P states the following[5]:

17 Although Avista's period of regulatory lag is expected to continue until 2023,
18 we believe Washington's SB 5295 legislation--passed in May 2021--could lead
19 to improvement in the company's credit quality. The law requires regulated
20 utilities in the state to file multi-year rate plans from two to four years in length.
21 In addition, it allows for the filing of out-of-cycle, multi-year rate plans if a
22 utility underearns and requires the Washington Utilities and Transportation
23 Commission to explore the possible adoption of performance-based
24 ratemaking. Overall, we view this legislation as positive for credit quality in
25 that the multi-year requirement is expected to reduce regulatory lag and
26 provide more cash-flow stability.
27
28 S&P also indicated that a key risk is the minimal cushion in the credit metrics at the current
29 rating level and that they expect regulatory lag to persist until 2023.[6] Because of the major
30 capital expenditures planned by Avista and future maturities of long-term debt, a supportive
31 regulatory environment is essential in maintaining our current credit rating.

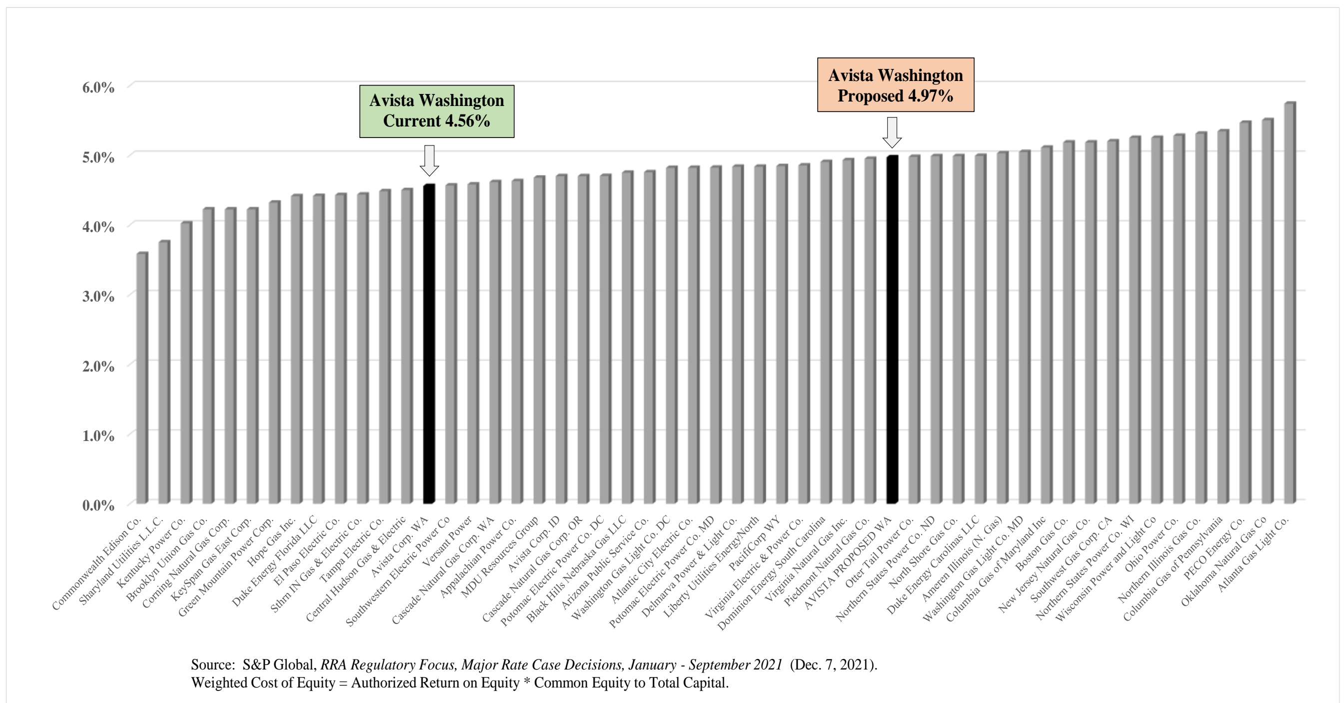
32 **Q. How does the Company's weighted average cost of equity compare to**

[4] Moody's Investor Service, Credit Opinion, August 2021.
[5] Standard and Poor's, Credit Opinion, August 2021.
[6] Ibid.

other utilities in the United States?

A. As shown in Illustration No. 1, Avista's <u>proposed</u> weighted average cost of equity is in-line with other utilities <u>authorized</u> weighted average cost of equity, and that our present weighted average cost of equity is at the low end of actual, commission-authorized values:

<u>Illustration No. 1 – Commission-Authorized Weighted Average Cost of Equity</u>



Source: S&P Global, *RRA Regulatory Focus, Major Rate Case Decisions, January - September 2021* (Dec. 7, 2021).
Weighted Cost of Equity = Authorized Return on Equity * Common Equity to Total Capital.

If the Commission simply carries over our existing ROE of 9.4 percent and 48.5 percent equity component, the weighted cost of equity would only be 4.56 percent, well below even the midpoint (4.76%) and average (4.79%) of Illustration No. 1 above.

Q. The requested return on equity of 10.25% is above that requested in Avista's last general rate case. What explains that?

A. Mr. McKenzie explains that the increased risks associated with a Two-Year Rate Plan and an earnings shortfall if the underlying assumptions are not realized. He also

1 addresses the increased risks associated with a business environment during the present
2 pandemic, as well as the prospects for increased interest rates.

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

5 A. Yes, it is absolutely essential. As a publicly traded company we have two
6 primary sources of <u>external</u> capital: debt and equity investors. As of September 30, 2021, we
7 had approximately $4.0 billion of long-term debt and equity. Approximately half of our
8 capital structure is funded by debt holders, and the other half is funded by equity investors
9 and retained earnings. Rating agencies and potential debt investors place significant emphasis
10 on maintaining credit metrics and credit ratings that support access to debt capital markets
11 under reasonable terms. Leverage – or the extent that a company uses debt in lieu of equity
12 in its capital structure – is a key credit metric and, therefore, access to equity capital markets
13 is critically important to long-term debt investors. This emphasis on financial metrics and
14 credit ratings is shared by equity investors who also focus on cash flows, capital structure and
15 liquidity, much like debt investors.

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

22 **Q. Are the debt and equity markets competitive markets?**

23 A. Yes. Our ability to attract new capital, especially equity capital, under

1 reasonable terms is dependent on our ability to offer a risk/reward opportunity that is equal to
2 or better than investors' other alternatives. We are competing with not only other utilities but
3 also with businesses in other sectors of the economy. Demand for our stock supports our stock
4 price, which provides us the opportunity to issue additional shares under reasonable terms to
5 fund necessary capital investments.

6 **Q. What is Avista doing to attract equity investment?**

7 A. We are requesting a capital structure that provides us the opportunity to have
8 financial metrics that offer a risk/reward proposition that is competitive and/or attractive for
9 equity holders. We have steadily increased our dividend for common shareholders over the
10 past several years, which is an essential element in providing a competitive risk/reward
11 opportunity for equity investors.

12 Tracking mechanisms, such as the Decoupling Mechanisms, the Energy Recovery
13 Mechanism and the Purchased Gas Adjustment approved by the regulatory commissions, help
14 balance the risk of owning and operating the business in a manner that places us in a position
15 to offer a risk/reward opportunity that is competitive with not only other utilities, but with
16 businesses in other sectors of the economy.

17 **Q. What is the Company's overall proposed cost of debt, and how does it**
18 **compare to its historically approved cost?**

19 A. Our requested overall cost of debt is 4.54%. The authorized cost of debt has
20 trended downward for Avista from 2010 to 2021, with an exception of an uptick in 2018 due
21 to low-cost debt that rolled off in 2016, as shown in Illustration No. 2 below.

1 **Illustration No. 2: Historic Cost of Debt (Washington)**

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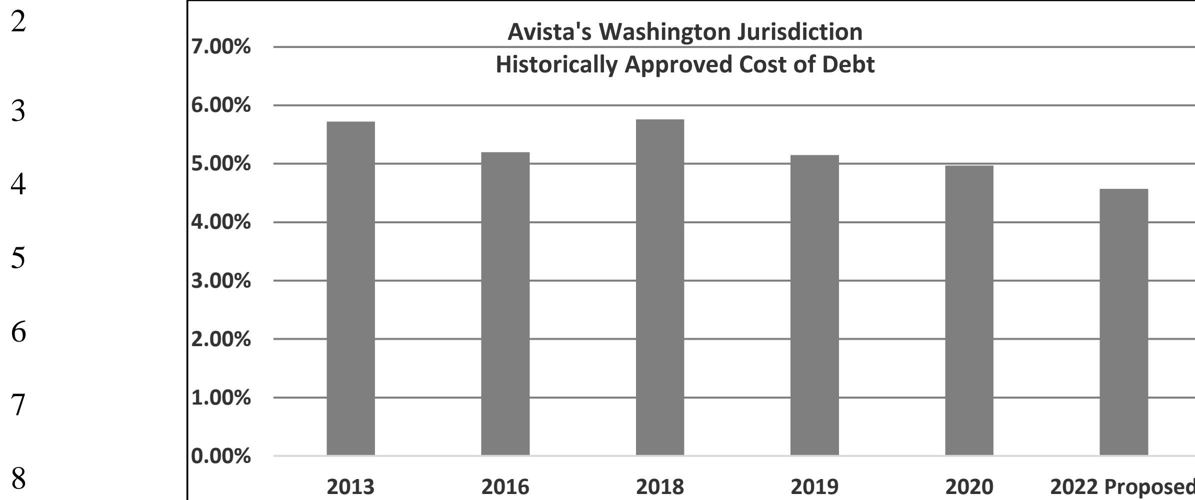

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9 **Q. Please explain why Avista's cost of long-term debt is trending down.**

10 A. There has been a general decline in interest rates over the past decade. At the
11 same time Avista has issued new debt to fund capital expenditures and to replace higher cost
12 debt maturing, which has caused the Company's overall cost of debt to decrease. We have
13 been prudently managing our interest rate risk in anticipation of these periodic debt issuances,
14 which has involved fixed rate long-term debt with varying maturities and executing forward
15 starting interest rate swaps to mitigate interest rate risk on a portion of the future maturing
16 debt and our overall forecasted debt issuances.

17 From 2016 through 2021 the Company issued $1.1 billion in long-term debt. The
18 weighted average interest rate of these issuances is 3.67%. These issuances have varying
19 maturities ranging from 30 years to 35 years. Our most recent issuance was funded partially
20 funded on September 28, 2021 and partially funded on December 1, 2021. This issuance was
21 a total of $140 million of first mortgage bonds with a thirty-year maturity was completed at a
22 coupon rate of 2.90%. On the September 28, 2021, the debt was priced and $45 million of

1 interest rate swaps were settled. These swaps were entered into in accordance with the
2 Company's Interest Rate Risk Management Plan (discussed in more detail later in my
3 testimony), in order to reduce concentration risk associated with a single issuance date. The
4 effective cost of this debt is approximately 3.63%, including the issuance costs and the cost
5 of settled interest rate hedges.

6 We have continued to take advantage of historically low rates. The Company's credit
7 ratings have supported reasonable demand for Avista debt by potential investors. We have
8 further enhanced credit quality and reduced interest cost by issuing debt that is secured by first
9 mortgage bonds.

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

12 A. Our future borrowing requirements are primarily driven by our significant
13 capital expenditure program and maturing debt, which creates exposure to interest rate risk.
14 As mentioned earlier, we have approximately $1.8 billion in forecasted capital expenditures
15 over the next four years. Additionally, we have $263.5 million of debt maturing during the
16 same period. We are forecasting the issuance of approximately $580 million in long-term
17 debt from 2022 through 2025 to fund these capital expenditures and maturing debt while
18 maintaining an appropriate capital structure.

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

1 several years leading up to the date we anticipate each issuance.

2 There are a number of factors that should be taken into consideration in choosing the 3 term of new debt issuances. For example, the current interest rate environment where the 4 interest rate spread for 30-year and 10-year terms is relatively narrow (i.e. presently there is a 5 low premium for 30-year debt versus 10-year debt), supports increased reliance on longer-6 term debt.

7 In addition, the average life of plant assets for Avista exceeds 30 years. A 30-year 8 term for debt is a closer match to the average life of the underlying assets that are being 9 financed. Decisions on the term of the debt are generally made closer to the time that new 10 debt is issued. Based on information available today, although the Company will consider 11 some amount of 10-year debt, the issuances will likely be heavily weighted toward a 30-year 12 term, due in large part to the matching of the financing to the life of the assets being financed, 13 and the narrow rate spread for 30-year vs 10-year terms.

14 **Q. Does the Company have guidelines regarding its interest rate risk 15 management?**

16 A. Yes. The Company's "Interest Rate Risk Management Plan", attached as 17 Confidential Exh. MTT-3C, is designed to provide a certain level of stability to future cash 18 flows and the associated retail rates related to future interest rate variability. The Plan 19 provides guidelines for hedging a portion of interest rate risk with financial derivative 20 instruments. We settle these hedge transactions for cash simultaneously when a related new 21 fixed-rate debt issuance is priced in the market. The settlement proceeds (which may be 22 positive or negative) are amortized over the life of the new debt issuance. The Interest Rate 23 Risk Management Plan provides that hedge transactions are executed solely to reduce interest

1 rate uncertainty on future debt that is included in the Company's five-year forecast. The hedge
2 transactions do not involve speculation about the movement of future interest rates.

3 **Q. Were the hedges that are included in the Company's cost of debt in this**
4 **filing consistent with the same hedging plan that the Company operated under in its last**
5 **several general rate cases?**

6 A. Yes. The hedges included in this filing were entered into a manner that is
7 consistent with the Company's Interest Rate Risk Management Plan in effect during prior
8 general rate cases. The Company has executed interest rate swaps, for purposes of reducing
9 interest rate risk for our customers as early as 2004 and has been fully transparent in
10 communicating its interest rate hedging activities. The settlement values, either losses or
11 gains, of the interest rate swaps have been clearly included as a component of cost of debt in
12 previous filings and this filing.

13 **Q. Turning now to return on equity ("ROE"), the Company is requesting a**
14 **10.25 percent ROE. Please explain why the Company believes this is reasonable.**

15 A. We agree with the analyses presented by Mr. McKenzie, which demonstrate
16 that the proposed 10.25 percent ROE, together with the proposed equity layer of 48.5 percent,
17 would properly balance safety and economy for customers, provide Avista with an
18 opportunity to earn a fair and reasonable return, and provide access to capital markets under
19 reasonable terms and on a sustainable basis. Please see the direct testimony of Mr. McKenzie
20 for his support of a 10.25 percent ROE.

21 **Q. Does the Company incur flotation costs?**

22 A. Yes, the company incurs flotation costs when equity is issued. These costs
23 include sale agent fees, registration fees and legal expenses. For example, for 2021, as of

1 September 30, 2021, the Company had incurred $0.9 million in flotation costs. These costs
2 have ranged as high as $1.1 million in recent years. Flotation costs are not recorded on the
3 income statement and are not included in the cost of capital. Common equity raised through
4 the sale of stock is recorded net of these costs. There are opportunity costs associated with
5 issuing equity and flotation costs that will be further discussed by Mr. McKenzie related to
6 the overall cost of equity.
7

8 **VI. CREDIT RATINGS**

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

10 A. We have a credit facility in the amount of $400 million with a maturity date of
11 June 4, 2026.[7] The credit facility involves participation by seven banks. Our credit facility
12 provides the ability to take out or repay short-term debt based on day-to-day liquidity needs
13 and to have letters of credit issued on the Company's behalf. The Company pays fees under
14 three price elements in the agreement: 1) a facility fee to maintain the right to draw on the
15 credit facility at any time, 2) interest on amounts borrowed, and 3) fees for letters of credit.

16 The Company may request letters of credit (LCs) underwritten by the participating
17 banks and established for the benefit of counterparties to Avista. LCs are often used as
18 collateral when required for energy resources forward commitments, forward swap
19 transactions to hedge interest rate risk on future long-term debt, and other contractual or legal
20 requirements that involve the Company.

21 **Q. How important are credit ratings for Avista?**

[7] The credit facility was originally established in 2011, amended in April 2014, extended in May 2016, amended and extended in June 2020, and then again in June 2021.

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

14 **Q. Please summarize the credit ratings for Avista.**

15 A. Avista' credit ratings, assigned by Standard & Poor's (S&P) and Moody's
16 Investor Service (Moody's) are shown in Table No. 3 below:

17 **Table No. 3 – Avista's Current Credit Ratings**

18

	S&P	Moody's
Senior Secured Debt	A-	A3
Senior Unsecured Debt	BBB	Baa2
Outlook	Stable	Stable

19
20

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

23 **Q. Please explain the implications of the credit ratings in terms of the**

1 **Company's ability to access capital markets.**

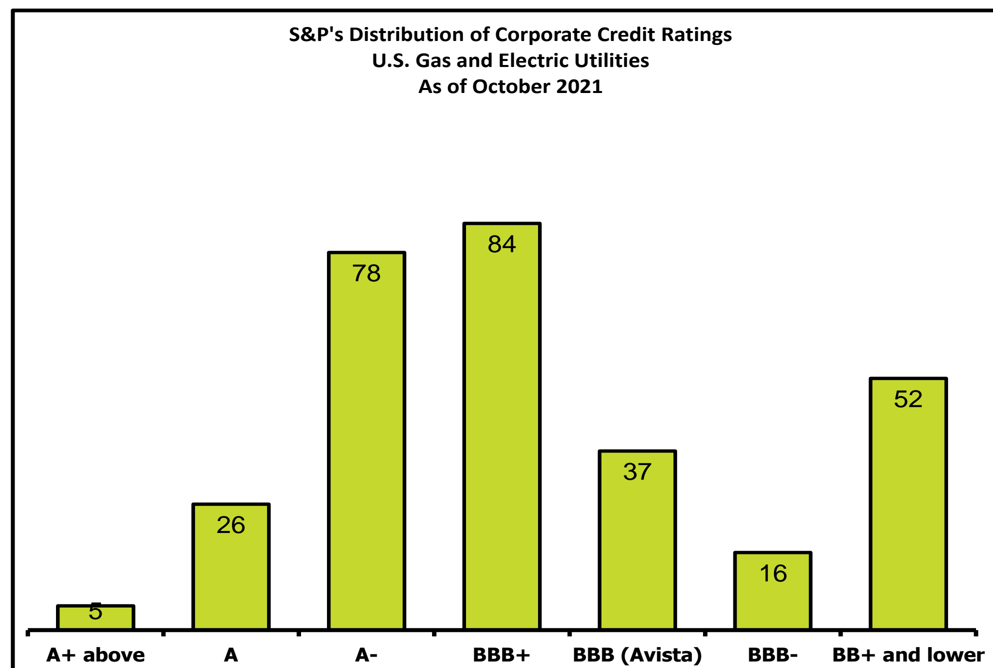
2 A. Credit ratings impact investor demand and expected returns. More
3 specifically, when we issue debt, the credit rating can affect the determination of the interest
4 rate at which the debt will be issued. The credit rating can also affect the type of investor who
5 will be interested in purchasing the debt. For each type of investment, a potential investor
6 could make, the investor looks at the quality of that investment in terms of the risk they are
7 taking and the priority they would have for payment of principal and interest in the event that
8 the organization experiences severe financial stress. Investment risks include, but are not
9 limited to, liquidity risk, market risk, operational risk, regulatory risk, and credit risk. These
10 risks are considered by S&P, Moody's and investors in assessing our creditworthiness.

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

16 **Q. What credit rating does Avista believe is appropriate?**

17 A. Avista's current S&P corporate credit rating is BBB. We believe operating at
18 a corporate credit rating level (senior unsecured) of BBB gives us the ability to continue to
19 attract investors and to achieve competitive debt pricing. Although a corporate credit rating
20 of BBB is a strong investment-grade credit rating, we continue to target a credit rating of
21 BBB+ which is comparable with other US utilities providing both electricity and natural gas.
22 As shown in Illustration No. 3, credit ratings for U.S. Regulated Combined Gas and Electric
23 Utilities are highly concentrated at A- or BBB+.

1 **Illustration No. 3 – S&P Corporate Credit Ratings - Utilities**



12 We expect that a continued focus on the regulated utility, conservative financing 13 strategies and a supportive regulatory environment will contribute toward an upgrade to a 14 BBB+ corporate credit rating for Avista. Operating with a BBB+ credit rating would likely 15 attract additional investors, lower our debt pricing for future financings, and make us more 16 competitive with other utilities. In addition, financially healthy utilities are better able to 17 invest in the required infrastructure over time to serve their customers, and to withstand the 18 challenges facing the industry and potential financial market disruptions.

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

20 A. Yes.