BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

DIRECT TESTIMONY OF GARY G. ELY

REPRESENTING AVISTA CORPORATION

Exhibit T___(GGE-T)

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

A. My name is Gary G. Ely and my business address is East 1411 Mission Avenue, Spokane, Washington. I am employed by Avista Corporation as Chairman of the Board, President and CEO.

Q. Please provide an overview of your professional experience at Avista.

A. I joined the Company in 1967. During my thirty-four years with Avista I have held positions in the engineering, operations, marketing and natural gas departments. In 1986 I was named Vice President of Marketing and then received the added responsibility of Gas Supply in 1989. In 1991 I was named Vice President of Natural Gas and was responsible for the Company's overall natural gas systems in Washington, Idaho, Oregon and California. Beginning in 1995, my responsibilities included the overall management of Avista's Hydro Production and Construction, Transmission and Generation Engineering, Rate and Regulatory matters at the state and federal levels, as well as Government Relations. I served as Executive Vice President of Avista Corporation from January 1999 to October 2000.

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

A. I am testifying as the policy witness for the Company, and, in addition to providing an overview of the filing, will introduce each of the other witnesses proffering testimony on the Company's behalf.

Q. Would you please summarize your testimony?

A. The combination of the worst hydroelectric conditions in 73 years of record together with unprecedented high wholesale market electric prices occurring at the same time has caused the need for prompt rate relief via a 36.9%

temporary electric surcharge in order to enable Avista to obtain financing to support its ongoing operations. For example, the Company has not yet been able to obtain construction financing for the Coyote Springs II project because lenders are concerned about the size of the Company's deferral balances and the absence of some form of rate relief to deal with the these deferred costs. Unless prompt rate relief is granted, the Company will not be able to complete financings necessary to fund the ongoing operations of the Company. If the needed cash is not forthcoming, the Company will not be able to borrow under its main line of credit, absent consessions from banks. With Commission approval of the requested surcharge, and recovery of the deferral balances, under current plans the Company would be able to continue to access capital to meet its obligations and complete construction of power resources necessary to meet future customer loads.

Q. Would you please provide a brief summary of the testimony of the other witnesses representing Avista in this proceeding?

A. Yes. In addition to myself, the following witnesses are presenting direct testimony on behalf of Avista.

Mr. Kelly Norwood, Vice President of Energy Resources, will present testimony regarding the unprecedented nature of the current stream flow conditions and power supply markets. Mr. Norwood will explain what costs went into the deferral account and why those expenditures were necessary to insure that the Company met its obligation to meet the retail load demands of our customers. Mr. Norwood explains why the Company's projections indicate that the deferral balance will not decline as previously indicated by the Company, and finally, he explains the credit to the rates of residential and small farm customers related to the BPA Residential Exchange Settlement Agreement which begins in October of this year.

Mr. Jon Eliassen, Senior Vice President and Chief Financial Officer will provide an overview of the cash flow impacts facing Avista. He will also provide an overview of the financing plans and strategies that will be required to meet the near and medium term operational needs of the Company.

Mr. Ron Peterson, Vice President and Treasurer of Avista Corp., will present testimony outlining the cash needs of the Company and will explain the financial covenants that must be met in order to assure continued access to reasonably priced capital to meet the day to day obligations of the Company. He will also explain certain financial benchmarks used by rating agencies to judge the credit worthiness of the securities the Company issues. Mr. Peterson also addresses how the nature and magnitude of the deferral balance is impacting the ability of the Company to raise needed capital.

Mr. Don Falkner, Senior Rate Analyst, discusses the calculation of the overall revenue requirement and the Company's request to use the deferred credit on the Company's balance sheet related to the monetization of the Portland General Electric (PGE) Sale Agreement as an offset to the power cost deferral balance to reduce the overall rate impact to customers. He will also discuss the Company's request to continue the deferred accounting mechanism through the proposed recovery period, ending December 31, 2003.

Mr. Brian Hirschkorn, Senior Rate Analyst, discusses the derivation of the requested surcharge increase of 36.9% and outlines how the Company proposes to spread the increase to various rate schedules and usage blocks within rate schedules. Mr. Hirschkorn also will discuss the mitigating impact of the Residential Exchange Settlement on the surcharge increase.

Q. Would you please briefly describe the regulatory background preceding this filing?

A. Yes. On August 9, 2000, in Docket No. UE-000972, the Commission approved the Company's request for a deferred accounting mechanism that allowed Avista to defer certain increased power supply related costs beginning July 1, 2000, and ending June 30, 2001. In Docket UE-000972, by order dated January 24, 2001, the Commission approved the Company's request to modify the deferred accounting mechanism to include certain other power supply related components and actual system load requirements in the deferral calculation effective December 1, 2000.

On May 23, 2001, the Commission approved a Settlement Stipulation between Avista and the other parties in Docket No. UE-010395 which, among other things, extended the deferred accounting mechanism through the earlier of February 28, 2003 or the date the deferred balance was estimated to become zero. In that Docket Avista explained that it had positioned the Company to be in a surplus power supply condition beginning in 2002, and that projections showed the value of the surplus would allow the Company to offset the deferred costs and reduce the balance to zero by February 28, 2003. The goal under the Settlement Stipulation was for the Company to fully recover its deferred costs without a price increase to its retail customers. As outlined in the Settlement, the ability to fully offset the deferred costs under the Settlement Stipulation, was based on a number of assumptions including, but not limited to, stream flow conditions, thermal plant performance, level of retail loads, and wholesale market prices during the deferral period. On page 4 of the Settlement Stipulation it states that:

> "The Company shall petition the Commission to alter, amend, or terminate the Settlement Stipulation (or propose other appropriate action) should the deferral balance increase or be reasonably anticipated to increase substantially due to unanticipated or

> uncontrollable events, such as an unplanned outage of a large Company-owned thermal unit, or worsening drought conditions. Nothing in this Settlement is intended to predetermine any issue in that proceeding or to preclude the Company from proposing any particular remedy in its Petition, including the need for rate relief."

After the Settlement Stipulation, power supply operating conditions for Avista have deteriorated substantially resulting in increased costs, due primarily to changes in hydroelectric generation and wholesale market prices. It was necessary for the Company to make additional purchases of energy at high prices from the short-term wholesale market in order to cover deficits caused by the further decline in hydroelectric generation. As further testified to by Mr. Norwood, these purchases were made prior to wholesale market price declines and Federally-mandated price controls. Furthermore, this recent decline in prices reduced the value of future surplus sales and it appears that it is no longer possible to offset the deferral balances.

At the time the Settlement Stipulation was developed, it was the Company's goal to not request a rate increase when the available information showed that there was an opportunity to recover the deferred costs without a rate increase. The Stipulation contemplated, however, that if conditions changed substantially, other action would be necessary to address recovery of the deferred costs, including rate relief.

Q. Would you please summarize what the Company is requesting in this filing?

A. Yes. The Company is requesting that the Commission approve a surcharge increase in rates for Avista's Washington electric customers of 36.9% effective September 15, 2001. Because of the Company's immediate need for rate relief, Avista is proposing that the surcharge be implemented "subject to refund." As will be explained later by Mr. Peterson and Mr. Eliassen, the Company has a critical and immediate need for increased cash flow and to reduce the size of the deferral balance. Implementing the rate increase "subject to refund" would allow the determination of the ultimate prudence of the deferred costs to occur during a future general rate filing while allowing the needed increase in cash flow to occur immediately. If, at the conclusion of the prudence determination, costs have been collected from customers that were determined to be imprudent, the appropriate refund or credit would be applied to customers on a going-forward basis.

Avista presently plans to file a general rate case during November of 2001. That filing would address, among other things, the prudence of the deferred power costs, the regulatory treatment of the Coyote Springs II project, a long-term periodic power cost adjustment mechanism, and the power supply related issues that the Commission ordered Avista to address in its Third Supplemental Order, dated September 29, 2000, in Docket No. UE-991606.

As discussed in detail by Mr. Hirschkorn, the Company is proposing that the surcharge remain in place until December 31, 2003. At the conclusion of the general rate case, the Company would modify the surcharge amount and the duration of the surcharge rate, if needed, in order to reflect the outcome of the general rate case.

The Company is proposing a compressed procedural schedule in this case because of its urgent need for rate relief. Prompt relief is necessary to improve cash flow, but more importantly, to begin to deal with the large deferral balances so that the Company can continue to finance expenditures for energy included in the deferral balance, for its construction expenditures, and its day-to-day operations.

By year-end, the Company could be precluded from borrowing under its primary commercial bank credit line. Investors and lenders are concerned about the size of the deferral balances and the absence of some form of rate relief to deal with the deferred costs. The Coyote Springs II generating resource is the next major resource being built to serve the Company's load obligations. It is imperative that the Company has the ability to obtain financing for projects such as Coyote Springs II, which will be an integral part of the resources needed to serve current and future customer loads.

The Company is planning to sell common stock this fall to provide a portion of the external funds needed. Financial advisors have told the Company that projections showing that Avista may not be able to borrow under its bank credit line will make it very difficult, if not impossible, to sell common stock at a reasonable price and in the time period the Company had planned.

Q. Would you please describe the current energy markets faced by the Company?

A. As Mr. Norwood discusses in more detail, Avista has experienced energy markets that are more expensive and more volatile than at any time in anyone's memory. In addition to the price volatility, we are now in the midst of what is the very worst hydroelectric condition experienced by the Company in the 73 years since records have been kept. I can say without hesitation, that in my 30 plus years with the Company I have never experienced anything quite like this, including the one hundred year ice storm of 1996 and the Washington Public Power Supply System problems experienced by the region in the 1970's and 80's. The Company has never incurred power supply costs of this magnitude and has never had such a small amount of generation available from its hydro system. Available generation from Avista's hydroelectric resources is 194 aMW below normal. At $100 per MWH the replacement cost of that much energy would be $170 million. Market prices in 2001 thus far have averaged well above $100 per MWH.

Of course, we are not alone in this. All of us are all too familiar with the situation in California and the reaction of the banking and financial community as discussed by Mr. Peterson. Other Northwest utilities have also been forced to implement rate increases of as much as 58% and BPA has recently announced a rate increase of 46%.

Q. What is status of the deferral balance?

A. As outlined by Mr. Norwood, the actual balance of the deferral account for the Washington jurisdiction at June 30, 2001 has increased to $109 million. Current estimates show a deferral balance for the Washington jurisdiction of $198 million at December 31, 2001, $211 million at the end of 2002, and $251 million at the end of 2003. If the natural gas deferral balance is included, the combined deferral balance as of December 31, 2001 is estimated to be $228 million ($318 million total system).

Q. Wouldn't it be possible for the Company to simply cut costs to address these financial concerns?

A. No. We continue to operate what I believe to be a very efficient utility. The magnitude of the dollars involved in the deferral balance simply overwhelm any savings we might reasonably expect to achieve without totally compromising reliable utility service. For example, Avista's total utility administrative and general expenses for 2000 were $62 million. To offset the deferral balance would require cuts that could not be accomplished without crippling our utility operations and our ability to provide even minimal levels of service. Unfortunately, the costs associated with the hydroelectric conditions and wholesale market prices overwhelm the benefits that cost-cutting measures might provide. The Company has, however, implemented budget cuts and other cost saving measures to reduce expenses and improve cash flow.

Q. What specific steps has the Company taken to lessen the impact of the deferral balances and what will the Company do to address the impact of this increase on lower income customers and those customers who otherwise may have difficulty paying their bills during the time this surcharge is in effect?

A. The Company has taken a number of measures to mitigate the increased power costs such as increased operation of its thermal resources, locking in fixed-price purchases in the prior year, and the installation of small generation resources.

We have also implemented new DSM Tariff funding levels and ramped up our conservation efforts including specific Tariff Rider funding for low-income customers. We have implemented three energy buy back programs to reduce electric load requirements and bring even more customer awareness to the new energy realities faced by the region. And, we will be putting even more emphasis on low-income assistance program in the coming months.

It is also important to recognize that the Company incurred over $20 million in additional power costs to serve Washington customers even before the deferral mechanism was in place. This amount represents a substantial loss that was entirely borne by shareholders.

Q. Do you have any concluding remarks?

A. Yes. Avista, the Commission, Commission Staff, and other parties have made extraordinary efforts to avoid the situation now facing the Company and its customers. However, conditions beyond the control of all of us have caused power costs to increase substantially, and it appears that the opportunity to offset the power costs in the future without a retail rate adjustment is no longer possible. Financial exigencies now require the Company to request a surcharge.

The Company has reviewed prior Commission orders regarding such a request and believes that Avista meets previously articulated criteria to be granted an immediate surcharge. To not grant a surcharge would clearly jeopardize the financial integrity of Avista and cause a detriment to our customers.

Q. Will the benefits from the Residential Exchange Settlement offset any of the increase resulting from the requested surcharge?

A. Yes. The BPA Residential Exchange Settlement Agreement, which begins in October of this year, will provide benefits to the Company's residential and small farm customers. Although the rate reductions related to the Residential Exchange benefits will be handled separately from the proposed surcharge rate increase, the timing of the Residential Exchange credit will serve to reduce the overall rate impact of the surcharge to approximately 22% for an average residential customer. The Company plans to file a proposal with the Commission in August to flow the benefits from Residential Exchange Settlement through to its customers. Mr. Norwood and Mr. Hirschkorn provide a more detailed overview of the Residential Exchange Settlement benefits.

Q. Does that conclude your direct testimony?

A. Yes, it does.