BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

DIRECT TESTIMONY OF JON E. ELIASSEN
REPRESENTING AVISTA CORPORATION

Exhibit T-___ (JEE-T)

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

A. My name is Jon E. Eliassen, and my business address is East 1411 Mission Avenue, Spokane Washington. I am employed by Avista Corporation as Senior Vice President and Chief Financial Officer.

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

A. I joined Avista Corp in 1970 as a General Accountant after graduating from Washington State University with a business degree. I then served in a number of positions, including Financial Analyst, Financial Supervisor and Treasurer, before being named Assistant Vice President of Finance and Treasurer in August 1985. I was appointed Vice President of Finance and Chief Financial Officer in 1986 and was named to my current position in August 1996.

I am a board member and Chair-Elect of the Western Energy Institute and am past president and member of the Board of Directors of the Financial Executives Institute, Inland Northwest Chapter, past member of Pacific Coast Gas Association, Edison Electric Institute and Western Electric Power Institute.

Q. Would you please summarize your testimony?

A. Avista Corp. is undergoing significant financial stress because the cost of obtaining power to meet customer needs is far exceeding the amount customers are paying for that supply. In addition to actions the Company has already taken and is continuing to pursue, it is now necessary to temporarily increase customers' rates to remedy the financial stress and provide the financial viability necessary for the Company to serve customers now and in the future at a reasonable cost.

The combination of the lowest hydroelectric generation conditions ever recorded by Avista, and unprecedented high and volatile wholesale market prices occurring at the same time, has caused the need for prompt rate relief in order to enable Avista Corp. to continue to obtain financing necessary to support the ongoing operations of the Company.

As explained by Mr. Norwood, hydroelectric conditions for 2001 have continued to deteriorate to the lowest level in the 73 years of record. The Company has been able to meet its retail loads by acquiring energy in the wholesale market, by purchasing natural gas to operate turbine generators for extended periods of time, by developing new small generation projects, and by aggressively developing and implementing conservation measures this year. The cost of these actions has caused the Company to incur in excess of $200 million in deferred power costs this year alone.

The Company has not been able to obtain construction financing for the Coyote Springs II project through normal channels. Commercial Bankers and other 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. Current estimates show that if prompt rate relief is not granted, and additional financing is not obtained, the Company will not be able to complete anticipated financing and will not be able to meet certain debt covenants by the end of this year. As a result, the Company would not be able to borrow under its short-term line of credit in the absence of extraordinary concessions by banks. With the requested surcharge, and with recovery of the deferral balances over a reasonable period of time, I believe the Company will be able to continue to access capital to meet its obligations.

Assumptions and forecasts have changed markedly in the short period since the Settlement Stipulation in Docket No. UE-010395. The result of the market and hydro system changes is that the Company has and will bear a financial hardship for power costs in the absence of increased revenues. The potential for relieving that hardship solely through future wholesale power markets has been greatly diminished or eliminated. The Company's ability to rely on energy markets to "ride out the storm" without price increases is no longer an option.

Q. Why is the Company requesting expedited treatment?

A. The Company has an urgent need for rate relief to improve cash flow. The Company must demonstrate to the financial community, to stockholders, lenders and rating agencies, that it has an opportunity to recover the energy deferral balances in the next 18 to 24 months. Prompt relief is necessary so that the Company can begin recovering deferred power costs, so it can continue to finance expenditures for energy, for construction of needed generation facilities and improvements, and for its day-to-day operations. As Mr. Peterson will testify, the Company has not yet obtained separate construction financing for the Coyote Springs II project. Although banks gave the Company verbal commitments and preliminary credit approval to finance the project, final credit approval required to proceed with the financing was not received due to the recent changes and concerns about the Company's credit risk and growing deferral balances. In addition, by the end of 2001, the Company could be precluded from borrowing under its primary commercial bank credit line. Investors and lenders continue to be 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 and some demand-side management programs were selected through Avista's 2000 Request for Proposals (RFP) process as the next resources to serve the Company's load obligations. It is imperative that the Company be able to obtain both interim as well as permanent financing for these new resources, which will be an integral part of the resources needed to serve future loads.

Q. What circumstances have led the Company to seek such a large surcharge?

A. Extremely poor hydroelectric conditions have forced Avista Utilities to buy power in the wholesale power market at greater volumes and at much higher prices than we have incurred in prior periods. The price levels the Company has incurred in wholesale markets are well above the level of power costs currently included in retail rates. Therefore, the Company has deferred significant excess power costs for the opportunity for later recovery. It was the Company's intent that surplus power resources available in 2002 and 2003 would be sold into the wholesale market to work the deferred cost balances back to zero. However, although forward power prices are still above historic levels embedded in our retail rate cost recovery structure, the value of surplus sales will not be adequate to offset current deferral balances and additional amounts that will be deferred during the remainder of 2001.

Even if the future value of surplus power was projected to be enough to offset the already incurred (and deferred) power costs, the deferrals have grown far beyond expectations and are exceeding the Company's capacity to borrow to finance them.

Without a revenue increase, the level of deferrals is too great for the Company to finance.

The Company has incurred over $142 million in deferred electric energy payments as of June 30, 2001 and will incur an additional $110 million to $125 million in the last six months of 2001. The total deferred electric payments will reach $267 million by year-end, which exceeds the Company's total line of credit of $220 million if it had the ability to borrow.

The amount of deferred gas commodity charges will also reach $50 million during this same period and the combined deferral balances will reach $318 million by year-end 2001. Absent tracking increases for gas, and a rate recovery mechanism for the electric deferrals, the Company has no way to recover these costs that have been incurred to serve customers. The Company has been required to utilize cash flows from operations, various bank borrowings and short- and long-term debt issuance to fund these deferred energy expenses.

We cannot continue to fund the deferrals, our capital construction program, and our daily operations without an increase in energy rates to collect these costs from energy users. And it is critical that the Company recover these costs within a reasonable time period. The Company has proposed a 27-month recovery period (through December 2003) in an attempt to balance the overall rate impact to customers and the need for timely recovery of the deferral costs.

We will be unable to access capital markets, to issue equity, or incur additional debt later this fall absent some recovery mechanism being put in place. Although the actual recovery can take place over roughly a two-year time period, the recovery of costs must begin immediately.

Q. Why are the projected deferral balances important?

A. It is doubtful at this time that the Company can even continue to fund the payments for energy currently contracted for to serve customers, absent a recovery mechanism. We cannot at this time assure this Commission that we will have adequate access to cash to make necessary energy purchases without a deferred cost recovery mechanism in place.

Q. Given growing deferral balances and construction needs, what are the Company's financing needs through the end of 2001?

A. In addition to the cash required to support power cost deferrals, Avista also has cash needs for funding gas deferrals, for normal construction and capital improvements, for the completion of construction of Coyote Springs II and a number of small generation projects, to fund conservation programs, and to repay maturing securities. Page 1 of Exhibit No. __ (JEE-1) includes a chart showing total electric and natural gas deferral balances for both the Washington and Idaho jurisdictions for each month of 2001. The chart includes actual balances through June 2001 and estimates for July - December 2001. The chart shows total electric and natural gas deferral balances of $318 million at December 31, 2001. Current estimates show that without a surcharge, utility financing needs will total $434 million from now until the end of 2002, primarily to fund energy costs, required utility construction (including generation projects), and debt and preferred stock maturities.

In the 2003 to 2005 time frame, the Company will also need access to capital markets to fund ongoing construction requirements and to refinance maturing obligations. Our current estimates of capital requirements in that three-year period are substantial.

Q. Why is it critical to improve the Company's cash flow?

A. Sufficient positive operating cash flows are a basic sign of a company's financial health. Avista's cash flows from operations have been increasingly negative, as it has been necessary to fund the deferred, but unrecovered, power costs. Improving the Company's cash flow is critical to being able to generate cash flows sufficient to fund Coyote Springs II, fund current and future power purchases, and to enable the Company to sell common stock. Approval of a surcharge will not only provide needed cash flows but, just as important, will be a signal to the financial community that the Commission will continue to take prompt actions to support the financial health of the Company. Commission support and action through a surcharge is critical to enable the Company to complete financing needed for continued utility operations and to help mitigate potential reductions in credit ratings.

Q. What would be the accounting treatment for the deferred power costs under generally accepted accounting principles if a surcharge is not granted in full or is partially granted?

A. If a surcharge is not granted in full, the deferred balance would be evaluated and those costs deemed not recoverable would be written off against current earnings.

Q. How would the utility's rate of return be affected if the deferred power costs could not be recovered?

A. It is important to note that because of the approved deferred accounting mechanism, recent utility earnings and rates of return have not fully reflected the impacts of the hydro and power market conditions discussed to this point. As an illustration, if the full impact of the deferral balance was reflected in income by amortizing the projected balance in the deferral account over twenty-seven months (October 2001 through December 2003) with no revenue offset, Avista's normalized Washington electric rate of return would be a negative 0.5% (-0.5%) over the amortization period. However, under this scenario, the Company would not be able to obtain financing for day-to-day operations.

Q. Can the Company pursue other financing rather than seeking a surcharge?

A. In my judgement, even if alternate financing were readily available, it would not solve the key issue facing the Company. We must be able to assure current investors, credit rating agencies, our commercial banks and lenders, as well as future investors and creditors of the Company that we can recover the deferral balances. If the Company cannot recover the deferred power costs already incurred, it may ultimately be unable to obtain any financing. Based on contracts in place today, the deferrals are already projected to reach a level that will equate to nearly 45% of the Company's total equity by the end of this year. Assurance of recovery of the deferred costs over a reasonable period of time is extremely critical to our Company and our customers.

At this time, it is doubtful that the Company would be successful in pursuing any other financing, at least in the magnitude required. Without some assurance of recovery of the deferral balances, the Company is precluded from most capital markets at any reasonable price. We are currently planning a construction loan or project-type financing structure for the Coyote Springs II project, but even if accomplished, the support for the underlying debt for the financing structure relies in large part on the credit of Avista Corp. While we have been attempting to structure an interim financing package for Coyote, one advisor did tell us that the recovery mechanism must be assured to successfully complete the deal through normal bank lending channels that would be available to other utility companies. Another advisor asked if we would issue securities subject to obtaining the surcharge, but that is a very impractical way to finance, and does not provide necessary capital in a timely manner.

It is very important to remember that much of the incremental cash required this year goes directly to purchasing electricity required to meet customer demand and to assure reliable supplies of electricity and natural gas.

Q. Why is a Commission order allowing recovery important?

A. It is critical for the financial viability of the Company to have a mechanism in place that is designed to recover the deferrals over a relatively short period of time. The deferrals were built up over a 15-month period, and we need to have assurance that they will be recovered in a reasonable time as well.

The Company has incurred cash expenditures for all of the deferrals, including real interest charged on any debt that was incurred to fund the deferrals. Our proposed recovery only returns about 60% of the actual cash expended for energy deferrals, since we propose amortizing other non-cash items (the PGE monetization deferral balance) to offset approximately $87 million of the $267 million deferral balance.

Q. Are banks and lenders just looking for cash from ratepayers or are they looking at other things?

A. Our banks – and the rating agencies – will be looking for cash, certainly. They will also be interested in how soon the balance of the deferrals can be reduced to reasonable levels. Our current plan provides that the balance will still be in the $62 million range by the end of the year 2002. I am reasonably comfortable that the banks and rating agencies will view achieving that level as acceptable. But, we will also need to demonstrate that we can issue additional equity as required, and strengthen the balance sheet by reducing the total debt ratio to approximately 50%. All of our creditors will be interested in seeing that cash coverage of fixed charges, as testified to by Mr. Peterson, will continue to strengthen in the next 18 months.

Q. Can't the Company just restructure its debt like others have done?

A. Restructuring debt or adding even more financing doesn't take care of the issue. The issue is recovering the deferred energy costs on our books. We will have spent $318 million in cash for these deferrals in an 18-month period ending December of this year. It is critical that we have some way to recover this cash, through revenues. Without a recovery mechanism, no amount of financial engineering will provide the Company the sound financial base it needs to continue to operate.

This is why we have asked for the surcharge. The Company must begin to recover its power costs and reduce the deferral balances. It is critical that the plan is put in place soon, so that there is assurance of recovery as we continue to finance payments that add to the balance in the deferral account through the end of this year.

Q. Why not amortize the deferral balance over a longer period, such as five years?

A. First, we wouldn't have enough cash to get there. The deferrals are growing too rapidly and are already much larger than anyone expected. In addition, there is not enough certainty that the balance would be recovered in the five-year time horizon, given uncertainty of future wholesale energy prices.

The Company must quickly reduce the deferral balances to a reasonable level. Based on our current plans, the deferral balance would be approximately $62 million at year-end 2002, and would be zero by year-end 2003. We really cannot extend the recovery beyond 2003, since we must continue to strengthen the Company financially to continue to have access to capital markets throughout this period. There will be the continuing need to improve our credit, generate adequate cash to fund utility construction, and plan for any additional resources that may be required.

We are not starting this process from a position of financial strength, and we must move as quickly as we can to shore up the Company's finances, reduce debt, improve interest coverage and give the Company the opportunity to earn the return authorized by this Commission.

Only by achieving these objectives will the Company be able to continue to access capital at reasonable cost and fund the business in the future.

Q. What has the Company done to generate or save cash to avoid this situation?

A. As discussed by Mr. Ely, the Company has implemented budget cuts and other cash-saving measures, initiated a hiring freeze, looked aggressively for alternate financing to minimize Company investment, and actively managed conservation programs to maximize benefits at minimum cost. The potential cash conservation from these steps is important, but it is not sufficient to satisfy the cash flow shortfalls that are caused by deferred power costs.

In addition, as Mr. Norwood has testified, the Company has been aggressively pursuing new generating resources that could be brought on-line quickly, to mitigate reliance on the uncertainties of the wholesale power markets.

Q. Does that conclude your direct testimony?

A. Yes, it does.

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EXHIBIT NO. ____ (JEE-1)

WITNESS: JON E. ELIASSEN, AVISTA CORP.

AVISTA UTILITIES

2001 Electric & Gas Deferral Balances

Actual Balances Through June 2001 and Estimates for July - December 2001