Exhibit No. ____ (CMBS-1T)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-07________

DOCKET NO. UG-07________

DIRECT TESTIMONY OF

CHRISTY M. BURMEISTER-SMITH

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Christy M. Burmeister-Smith. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corporation as Vice President and Treasurer.

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

A. I received a Bachelors degree from Boise State University with an emphasis in accounting. I have also attended a variety of utility finance courses and leadership programs during my 27+ year utility career.

I joined Avista in 1980. I was named Vice President and Treasurer in January 2006. I was Vice President and Controller from June 1999 – January 2006. For the nineteen-year period prior to June 1999, I was employed by the Company in various other staff and management positions.

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

A. I will provide an overview of Avista's amortization methodology related to premiums and discounts on repurchased debt and I will explain the amortization methodology required by FERC General Instructions 17 (FERC 17).

Q. What relief is Avista requesting?

A. Avista is requesting that the Commission issue an order authorizing the continued use of the current accounting treatment for the debt repurchases that have occurred to date.

II. AMORTIZATION OF DEBT PREMIUMS AND DISCOUNTS ON REPURCHASED DEBT

Q. Please provide an overview of the recent issue raised in Docket No. U-070311 related to the amortization of premiums and discounts on repurchased debt.

A. Commission Staff recently raised concerns regarding the appropriate amortization period of debt repurchase costs for the period 2002 to 2006. Although Avista had the authority to defer the debt repurchase costs, the concerns center around the time period over which the Company chose to amortize the debt repurchase costs.

Under WAC 480-90-203 and WAC 480-100-203 the WUTC has adopted the uniform system of accounts as prescribed by FERC. FERC's General Instruction 17 specifies the accounting treatment related to the repurchase of debt. Under FERC 17 when previously issued debt is repurchased, the premiums paid to repurchase the debt are to be amortized over one of the following time periods: 1) expense the cost in the current year if the cost is small, 2) amortize the cost over the remaining life of the original debt, or 3) amortize the cost over the life of the new debt.

As Avista began repurchasing debt in 2002, it chose to amortize the repurchase costs over the average life of all of Avista's outstanding debt. The Company relied upon Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of

Regulation (FAS 71), as the basis for the accounting treatment. In general terms, FAS 71 allows certain accounting treatment if it is probable that the costs will be allowed for ratemaking purposes.

Q. What is the Company's current view on this issue?

A. After further review of FERC 17 and FAS 71, the Company is in agreement with Commission Staff that beginning in 2002 Avista should have either applied FERC 17, or obtained an order in advance of adopting a methodology other than that prescribed by FERC 17.

Avista did not intentionally or willfully violate FERC 17 or WAC 480-90-203/480-100-203, and did not seek an accounting method that would benefit one stakeholder at the expense of another. As I will explain later in my testimony, we believe the method that was chosen has not, and will not cause harm to customers. The Company requests that the Commission allow the current accounting treatment to remain in place for those debt repurchases that have already occurred. For any new debt repurchases, the Company commits to use FERC 17 or to seek prior approval for a method other than FERC 17.

Q. Please explain the background related to the amortization methodology of debt premiums and discounts utilized by Avista.

A. Historically, Avista Corp had ready access to economic sources of funds to finance its capital expenditure program, refinance maturing debt, and meet cash requirements for other corporate purposes. Prior to 2000, Avista's interest rates were relatively stable, which did not make it beneficial to redeem or repurchase debt prior to maturity.

During the energy crisis of 2000 and 2001, the Company's access to funds was severely limited. At the same time, it was necessary for the Company to issue a significant amount of debt to cover electric and natural gas costs in excess of those included in base rates.

In the spring of 2001, Avista issued $400 million of 9.75 percent Senior Unsecured Notes. A significant portion of the funds were used to purchase power and natural gas, at high prices, to serve our customers' load. Due to the Company's weak financial position, at the time the Notes were issued, the Notes carry a number of restrictive covenants. Additionally, when Avista's credit rating fell below investment grade, the interest rate on other notes issued by Avista (maturing in 2003) increased to 9.125 percent from 8.625 percent.

As a part of the plan to reduce interest costs, Avista initiated a plan to opportunistically repurchase blocks of the 9.75 percent and 9.125 percent debt. The repurchases consisted of small blocks of notes that were being traded in the marketplace. By repurchasing notes, in small blocks, the Company reduced the level of interest while also reducing total debt. This method of repurchasing the debt is less costly than a larger tender offer for a significant portion of the notes, which would have bid up the premium paid to repurchase the debt. It was also inefficient to issue new debt in small increments as it would have significantly increased issuance costs.

Q. What is the current accounting treatment utilized by Avista?

A. As Avista repurchased debt during the 2002 – 2006 periods, it began amortizing the costs of the repurchases (premiums and discounts) over the average life of all of Avista's outstanding debt. As an example, the amortization period for the debt repurchased in 2002 was eight years, based on the average life of all debt outstanding at that time. When Avista began repurchasing the higher-cost debt, it chose an amortization method that it believed was reasonable and appropriate.

The Company's intent was to utilize a method that would amortize the debt repurchase costs over a period that was in the best interest of all stakeholders. The Company determined it could not tie these repurchases to specific financings, and it chose to amortize the premium and discounts over the average life of outstanding debt within the Company's debt portfolio (short, intermediate and longer-term debt).

Q. What was the basis for the accounting method chosen by Avista for the amortization of debt repurchase costs?

A. Accounting methodologies are determined based on Generally Accepted Accounting Principles (GAAP) together with accounting and rate making treatment granted by regulatory commissions. Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (FAS 71), applies specifically to regulated utilities. FAS 71 provides the following guidance:

> Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:
>
> a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.
>
> b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected level of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, the criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred costs.

Additionally, in Appendix B of FAS 71, the application of general standards to specific situations of early extinguishment of debt is detailed as follows:

> Opinion 26 requires recognition in income of a gain or loss on an early extinguishment of debt in the period in which the debt is extinguished. For rate-making purposes, the difference between the enterprise's net carrying amount of the extinguished debt and the reacquisition price may be amortized as an adjustment of interest expense over some future period.

The provisions of FAS 71 require that the recovery be probable and the statement defines "Probable" as "*the future event or events are likely to occur.*"

Avista has deferred other costs and amortized those amounts over a period of time in order to mitigate the impact in any one year on customers. For example, Avista initially deferred costs related to Grid West, WNP-3 and Skagit and then amortized those costs over a reasonable period of time to mitigate the impact to customers. We believe the time period and method chosen to amortize the debt repurchase costs was reasonable. However, Avista acknowledges that it should have sought and received Commission approval to amortize those costs over a reasonable period of time.

Q. Please explain the amortization methodology required by FERC 17 related to debt repurchase costs.

A. The pertinent provisions of FERC 17 are as follows:

> Reacquisition, without refunding - When long-term debt is reacquired or redeemed without being converted into another form of long-term debt and when the transaction is not in connection with a refunding operation (primarily redemptions for sinking fund purposes), the difference between the amount paid upon reacquisition and the face value; plus an un-amortized premium less any related unamortized debt expense and reacquisition costs; or less any unamortized discount, related debt expense and reacquisition cost applicable to the debt redeemed, retired and canceled, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility shall amortize the recorded amounts

> equally on a monthly basis over the remaining life of the respective security issues (old original debt). The amounts so amortized shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt – Credit, as appropriate.
>
> Reacquisition, with refunding - When the redemption of one issue or series of bonds or other long-term obligations is financed by another issue or series before the maturity date of the first issue, the difference between the amount paid upon refunding and the face value; plus any unamortized premium less related debt expense or less any unamortized discount and related expense, applicable to the debt refunded, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility may elect to account for such amounts as follows:
>
> (1) Write them off immediately when the amounts are insignificant.
> (2) Amortize them by equal monthly amounts over the remainder of the original life of the issue retired, or
> (3) Amortize them by equal monthly amounts over the life of the new issue.
>
> Once an election is made, it shall be applied on a consistent basis. The amounts in (1), (2) or (3) above shall be charged to account 428.1. Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt – Credit, as appropriate.

In summary, under FERC 17 when debt is repurchased and new debt is not issued to accomplish the repurchase, then the costs to repurchase the debt would be amortized over the remaining life of the original debt that was retired. On the other hand, if new debt is issued to accomplish the repurchase, then the Company can elect to: 1) expense the costs in the current year if the cost is small, 2) amortize the costs over the remainder of the original life of the debt retired, or 3) amortize the costs over the life of the new debt.

Q. What is the existing rate treatment in Avista's jurisdictions?

A. The debt repurchases occurred during the time period 2002 forward. The test periods utilized in general rate cases filed in each of Avista's jurisdictions since that time have included the accounting for the repurchases using the Company's current accounting treatment, i.e. amortization of debt repurchase costs over the average remaining life of all debt.

The current method of amortization of the debt repurchase costs was embedded in the long-term debt costs that were approved by the Idaho Public Utilities Commission (IPUC) in October 2004 in Order No. 29602, in Case No. AVU-E-04-1 and AVU-G-4-1.

The last general rate case in the Company's Oregon jurisdiction included a 2002 test period, and the current method of amortization of the debt repurchase costs was embedded in the long-term debt costs approved by the Oregon Public Utility Commission (OPUC) in Docket No. UG 153, Order No. 03-570. In addition, recently the OPUC Staff completed their audit of the Company's 2005 Oregon jurisdiction results. During the audit, Oregon staff reviewed the accounting method for debt repurchase costs and accepted it without adjustment.

In the Company's Washington jurisdiction, in both the 2004 gas general rate case (Docket No. UG—041515, August 2004) and 2005 electric and gas general rate case (Docket Nos. UE-050482 and UG-050483), the repurchased debt was accounted for in the same manner as in previous years. During the 2004 natural gas general case, the WUTC Staff questioned the Company's method of accounting for the repurchased debt through informal correspondence, but accepted the costs for purposes of that case, and did not recommend different accounting treatment at that time. No party raised the debt amortization issue in the subsequent 2005 electric and natural gas general rate case proceeding (Docket Nos. UE-050482 and UG-050483).

Q. What is the impact on customers from this issue related to the amortization of debt repurchase costs?

A. We believe customers have not been harmed under the current accounting method. A comparison of the annual amortization amounts, between the two amortization methods, does not represent what customers have paid, or will pay, because none of the amortization was included in rates for 2002 – 2005 for electric customers (electric rates were not changed to reflect the amortization amount until January 1, 2006). Gas customers received a lower amortization amount in the 2004 rate case.

Chart 1 below represents the annual amortization of debt repurchase costs if FERC 17 had been used:

Chart 1

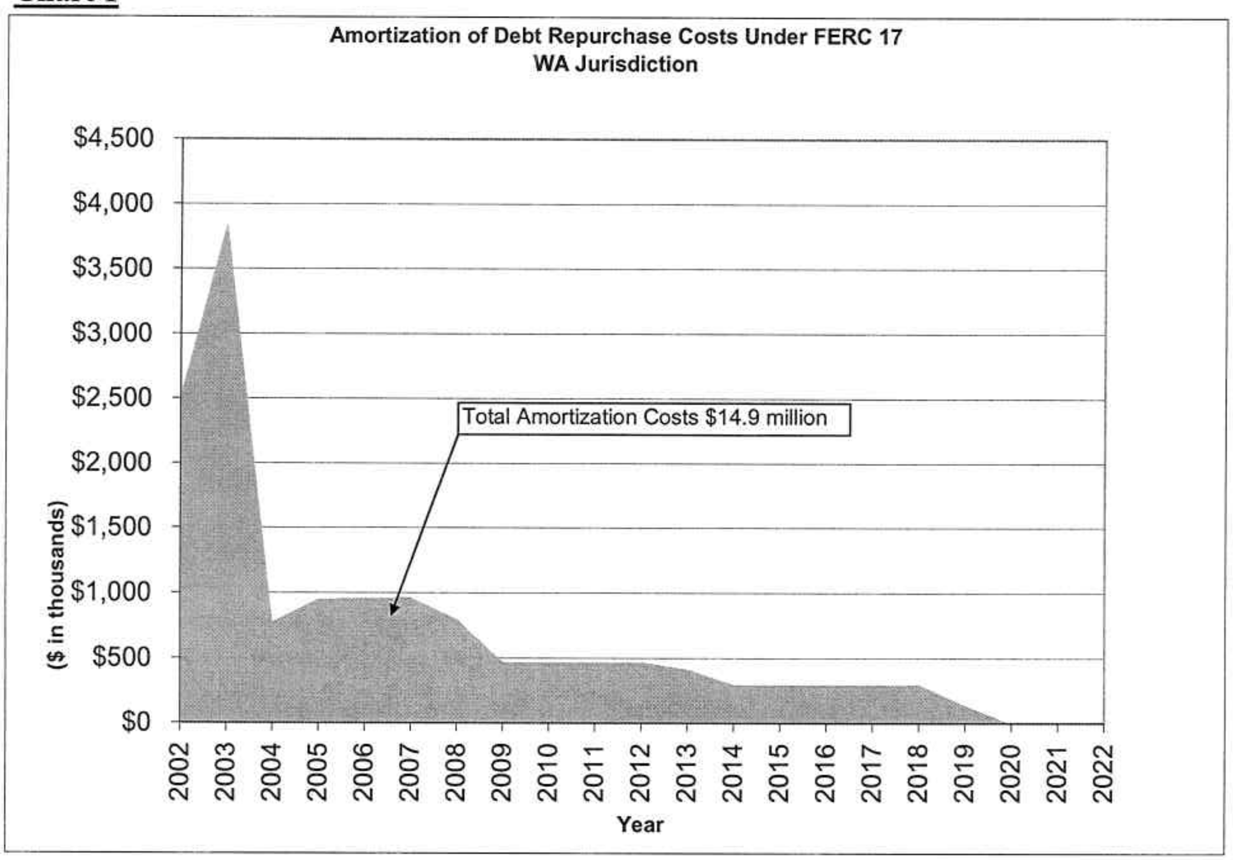
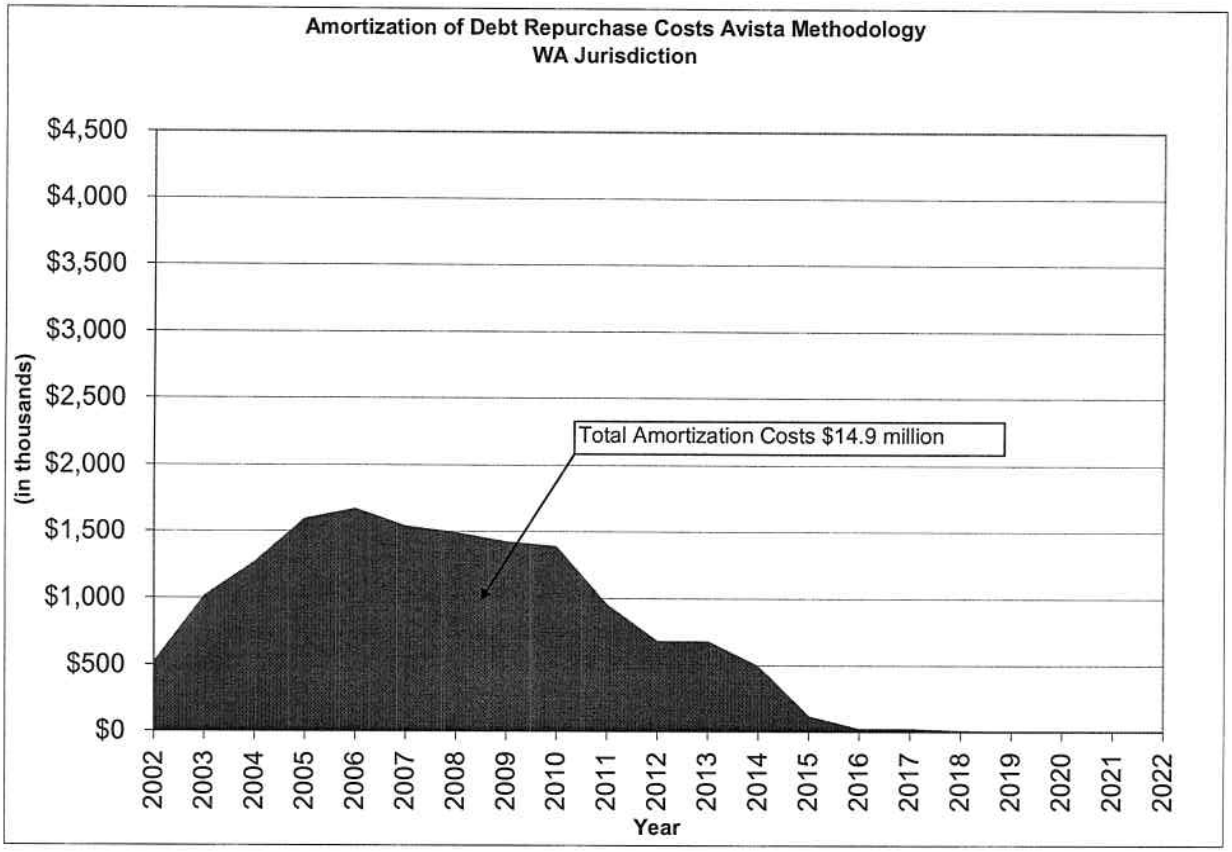


Chart 2 below represents the annual amortization of debt repurchase costs as amortized by Avista:

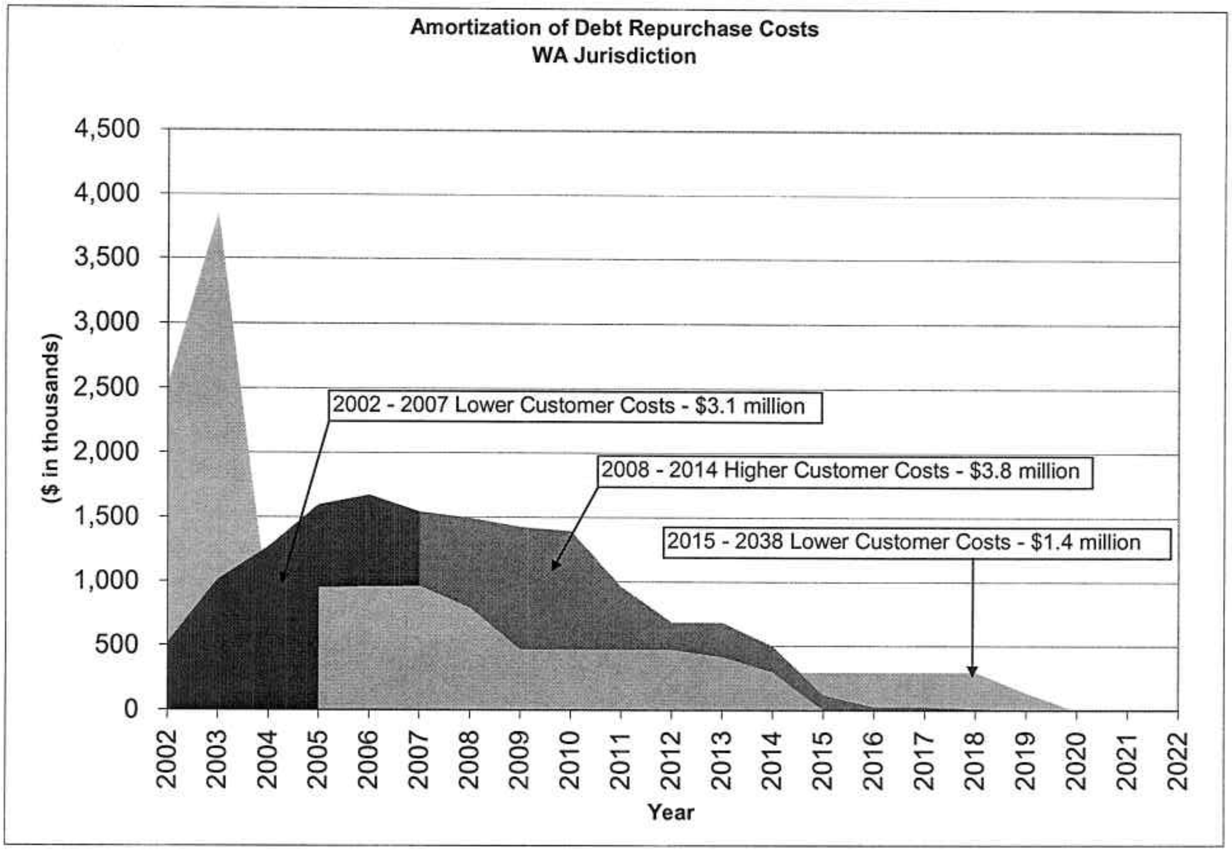
Chart 2



As noted in the above graphs, both methods (FERC 17 and the methodology used by Avista) will result in the same total amortization. Additionally, as noted in chart 3 below, Avista did not recover from customers the debt repurchase costs of approximately $3.1 million for the period 2002 through 2007 due to the fact that Avista was amortizing costs that were not being recovered in rates.

Chart 3 indicates that the amortization expense under Avista's method will be higher by approximately $3.8 million for the period 2008 through 2014, and lower by $1.4 million for the period 2015 through 2038.

Chart 3



Therefore, when all periods are taken into account, customers will pay approximately $700,000 less than the amount actually amortized by the Company. The following table summarizes the net lower customer costs:

TABLE 1 (in millions)		
Lower customer costs 2002 - 2007	$	3.1
Higher customer costs 2008 - 2014		(3.8)
Lower customer costs 2015 - 2038		1.4
Net lower customer costs	$	0.7

Q. What relief is Avista requesting related to debt repurchase costs?

A. Avista respectfully requests that the Commission issue an order authorizing the continued use of the current accounting treatment for the debt repurchases that have occurred to date. The Company commits that for any new debt repurchases, it will use FERC 17, or request an accounting order from the Commission prior to new repurchases of debt, if it desires to use an accounting method other than FERC 17.

Q. Does that conclude your prefiled direct testimony?

A. Yes.