Exhibit ______ (MRL-2)
Docket No. UE-010395
Witness: Merton R. Lott

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Avista Corporation's) Petition for Recovery of Expenditures) Related to Electric Deferral Mechanism))	**DOCKET NO. UE-010395**

EXHIBIT OF

MERTON R. LOTT

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

RE: AVISTA PETITION FOR 37% EMERGENCY SURCHARGE

August 24, 2001

1. **Avista's SEC Form 10-Q (November 14, 2000).**

On November 14, 2000, in its SEC Form 10-Q for the quarter ended September 30, 2000, Avista included the following note on page 15, of the report:

> "*Power Costs Deferrals*
>
> On August 9, 2000, the Washington Utilities and Transportation Committee (WUTC) approved the Company's request for deferred accounting treatment for certain power costs related to the recent increase in short-term wholesale market prices. Deferred accounting treatment is effective for power costs beginning July 1, 2000 and ending June 30, 2001. The specific power costs deferred include the changes in power costs to the Company from those included in the Company's base retail rates, related to three power cost components: the net effect of changes in short-term wholesale market prices on short-term wholesale purchases and sales; the effect on power costs from changes in the level of hydroelectric generation; and the net effect on power costs from changes in the level of thermal generation (including changes in fuel prices). The deferrals each month are calculated as the difference between the actual costs to the Company associated with these three power cost components, and the level of costs included in the Company's base retail rates. The power costs deferred are related solely to the operation of the Company's system resources to serve its system retail and wholesale load obligations. Deferrals do not include losses associated with wholesale trading activity. During the third quarter of 2000, the Company deferred $30.8 million in power costs pursuant to the WUTC accounting order. Regulatory approval of the recovery of these deferred costs will be addressed in a future regulatory proceeding, in which the Company is required to support the reasonableness and prudence of the costs, and that the Company's resources were optimized to the benefit of its retail customers."

2. **Avista's Form 10-K (March 8, 2001).**

In its SEC Form 10-K, Avista made several references to the power cost deferral. In item 1 under "Regulatory Issues" on page 10, Avista wrote:

> "<u>Power Cost Deferrals (Washington)</u> On August 9, 2000, the WUTC approved Avista Utilities' request for deferred accounting treatment for certain power costs related to increases in short-term power prices beginning July 1, 2000 and ending June 30, 2001. The specific power costs deferred include the changes in power costs to Avista Utilities from those included in base retail rates, related to three power cost components: the net effect of changes in short-term wholesale market prices on short-term wholesale purchases and sales; the effect on power costs from changes in the level of hydroelectric generation; and the net effect on power costs from changes in the level of thermal generation (including changes in fuel prices). The deferrals each month are calculated as the difference between the actual costs to Avista Utilities associated with these three power cost components, and the level of costs included in Avista Utilities' base retail

rates. The power costs deferred are related solely to the operation of Avista Utilities' system resources to serve its system retail and wholesale load obligations. During 2000, the Company deferred a total of $33.9 million under this accounting order.

On January 24, 2001, the WUTC approved a modification to the deferral mechanism to recover power supply costs associated with meeting increased retail and wholesale system load requirements, effective December 1, 2000. The WUTC also required Avista Utilities to file a proposal by mid-March 2001 that will address the prudency of the incurred power costs, the optimization of Company-owned resources to the benefit of retail customers, the appropriateness of recovery of power costs through a deferral mechanism, a proposal for cost of capital offsets to recognize the shift in risk from shareholders to ratepayers and Avista Utilities' plan to mitigate the deferred power costs. Avista Utilities also plans to file for an extension of the deferred accounting treatment beyond June 30, 2001."

The Company repeated this statement under item 7, pages 26 and 27 of Avista's Form 10-K (moving only the reference to the $33.9 in Washington Power Deferrals to a separate paragraph). Then again on pages 52 and 53 in note 1, "Summary of Significant Accounting Policies," of the NOTES TO FINANCIAL STATEMENTS, Avista included nearly an identical statement as the one quoted above.

Avista's SEC Form 10-K also included the following statements:

Page 24:

"The Company expects Avista Utilities' electric and natural gas business to earn between $0.90 and $1.00 per share for 2001, based on current streamflow and weather projections, anticipated purchased power prices and the continued ability to defer excess purchased power costs."

Page 32:

"The Company's cash flows have been affected because of the higher power and natural gas costs, as well as cash collateral required for counterparties and trading at Avista Energy. The higher power and natural gas prices are expected to continue to affect cash flows during 2001. The purchased power and natural gas costs incurred to serve the utility's retail customers are generally recovered or expected to be recovered in retail rates, however, there is a lag between the time the costs are incurred by the Company and the time they are collected from customers. As more fully described in Note 1 of Notes to the Financial Statements – "Power Cost Deferrals and Power and Natural Gas Adjustment Provisions", costs in excess of those included in rates are deferred as an asset on the balance sheet. Deferral balances at the end of 2000 totaled $78.8 million. Costs during 2001 are expected to continue to exceed the levels included in rates and, as a result, deferral balances are expected to increase during 2001. Because of the continuing high level of power and natural gas prices, a significant change in company resource availability (such as hydro generation) or customer demand could have a significant positive or negative impact on expected deferrals and cash flows. On an interim basis, the Company uses its revolving line of credit to fund these costs to the extent that they exceed the cash flows available from operations. The Company expects to issue longer-term debt during 2001 to pay down balances outstanding under the revolving line of credit. This will provide additional liquidity needed to fund the deferral balances. The Company intends to file applications with regulatory commissions during 2001 to address timing of recovery of the deferred costs. If the commissions approve the Company's requests, the deferral balances are expected to begin being recovered starting in 2001 or 2002. The Company's existing lines of credit are expected to be adequate to meet the current needs."

Page 37:

"*Other Operating Risks.* In addition to commodity price risk, Avista Utilities' commodity positions are also subject to operational and event risks including, among others, increases in load demand, transmission or transport disruptions, fuel quality specifications and forced outages at generating plants. Some of these factors have been addressed in the recent changes to the Washington deferred power accounting adjustment and the Idaho PCA."

Page 52:

"The Company's primary regulatory assets include Investment in Exchange Power, conservation programs, deferred income taxes, unrecovered purchased gas costs, deferred power costs, the provision for postretirement benefits and debt issuance and redemption costs."

3. Annual Report to Shareholders (2000).

Avista's 2000 Annual Report to Shareholders is not excerpted here. Appendix A to that report, entitled "2000 Financial Report," included (for the most part) a subset of the pages in the 10-K. Thus, except for the reference from part 1, page 10, of the 10-K, all the same references quoted above in this exhibit are included in the Company's 2000 Financial Report.